82-1331

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

LOUISIANA PUBLIC SERVICE COMMISSION,
Petitioner

versus

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Where the rate regulation of certain offerings of communications common carriers has historically been the exclusive prerogative of the states, with a federal regulatory agency created by Congress to exercise regulatory power in those areas that cannot be reached by state regulatory agencies, may the federal agency adopt a new policy of "non-regulation" of these offerings, and while declining to exercise its own jurisdiction, issue preemption orders that preclude the states from exercising their regulatory powers?*

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* The following parties were petitioners in the consolidated proceedings before the court of appeals:

> Computer & Communications Industry Association (No. 80-1471); The People of the State of California and the Public Utilities Commission of the State of California (No. 81-1193); Independent Data Communications Manufacturers Association, Inc. (No. 81-1217); National Association of Regulatory Utility Commissioners (No. 81-1222); American Newspaper Publishers Association (No. 81-1224); Datapoint Corporation (No. 81-1223); Motorola, Inc. (No. 81-1226); and U.S. Telephone and Telegraph Corporation (No. 81-1327).

The following parties were intervenors in the proceedings before the court of appeals:

> Aeronautical Radio, Inc.; American Telephone & Telegraph Company; American Petroleum Institute; Association of Data Processing Service Organizations, Inc.; Bunker Ramo Corporation; Central Telephone & Utilities Corporation; Citicorp; Communications Satellite Corporation; Computer & Business Equipment Manufacturers Association; Comsat General Corporation; Continental Telephone Corporation;

(Footnote Continued)

Control Data Corporation; GTE Service Corporation; GTE Telenet Communications Corporation; Hazeltine Corporation; International Business Machines Corp.; ISA Communications Services, Inc.; Louisiana Public Service Commission; MCI Telecommunications Corporation; National Burglar & Fire Alarm Association, and Alarm Industry Telecommunications Committee; North American Telephone Association; RCA Global Communications, Inc.; Satellite Business Systems; Southern Pacific Communications Company; Sperry Univac Division of Sperry Corp.; Tymnet, Inc.; United Computing Systems, Inc.; United Telephone Systems, Inc.; Utilities Telecommunications Council; Western Union Telegraph Company; and Xerox Corporation.

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PETITION FOR A WRIT OF CERTIORARI

The Louisiana Public Service Commission, petitioner, hereby petitions the Court to issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered on November 12, 1982.

OPINIONS BELOW

The opinion of the court of appeals, which is reproduced in the Appendix commencing at page A-1, is reported as *Computer and Communications Industry Association v. Federal Communications Commission*, 693 F.2d 198 (D.C. Cir. 1982).

The ruling of the Federal Communications Commission, known as the *Computer II* decision, is set forth in three reported orders issued in the docket styled *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Docket No. 20828 (F.C.C.). They are:

> "Final Decision," 77 F.C.C. 2d 384 (1980); "Memorandum Opinion and Order," 84 F.C. C.2d 50 (1980); "Memorandum Opinion and Order on Further Reconsideration," 88 F.C. C.2d 512 (1981).

These orders are voluminous. Rather than reprint them in the Appendix, we have lodged a copy with the Clerk, subject to the requirement that the orders be reprinted if the Court directs.

JURISDICTIONAL GROUNDS

The decision of the United States Court of Appeals for the District of Columbia Circuit was entered November 12, 1982. No application for rehearing was filed. This Court has jurisdiction to review the decision of the court of appeals pursuant to 28 U.S.C. §1254(1).

STATUTORY PROVISIONS

The following statutes, set forth in the Appendix commencing at page A-48, are involved in this case:

47 U.S.C. §152

47 U.S.C. §203

47 U.S.C. §221

STATEMENT OF THE CASE

1. Preliminary statement.

This case presents the issue of whether a federal agency may broadly preempt state regulatory power over the marketing of telecommunications equipment on the ground that the exercise of state power might interfere with a federal "policy" that is newly created by the agency, but neither embodied nor implied in any federal statute. The Federal Communications Commission ("FCC"), an agency created by Congress, determined that "competition" had arisen in the marketing of "customer premises equipment" and "enhanced services" by communications common carriers and others. Therefore, it decided that those offerings should no longer be regulated.

To implement its new policy, the FCC first determined that it had no duty to regulate customer premises equipment and enhanced services, either because its statutory jurisdiction did not encompass these offerings or because regulatory abstention is permissible under the statute. This decision in itself could not accomplish deregulation, however, because the states historically have set the rates for customer premises equipment that is used jointly for intrastate and interstate communications and the services performed by this equipment, pursuant to the division of authority envisioned in the Communications Act. Thus, to avoid any conflict with the agency-created federal "policy," all state power to tariff this equipment was preempted by the FCC. [1] This decision was affirmed by the United

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1 The decision of the FCC occurred in a rulemaking proceeding known as the "Second Computer Inquiry," or "Computer II." *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Docket No. 20828

States Court of Appeals for the District of Columbia Circuit ("court of appeals").[2]

2. Course of proceedings in the FCC.

The rulemaking proceeding of the FCC, known as the "Second Computer Inquiry" or "Computer II," was instituted in 1976 to reexamine determinations made in the First Computer Inquiry and embodied in Rule 64.702 of the Rules of the FCC.[3] The First Computer Inquiry established the definitional distinction between "communications" services and "data processing" services and implemented two regulatory principles: (1) the FCC would forbear from regulation of data processing services, and (2) carriers could not provide data processing services, except through a separate subsidiary.[4] Computer II was assertedly required because of technological advances resulting in "a blurring of the distinctions between data processing and communications."[5] The notice of inquiry set forth a suggested amendment to Rule 64.702 that would "positively" define data processing

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(1 Continued)
(F.C.C.); "Final Decision," 77 F.C.C.2d 384 (hereinafter referred to as "Computer II Final Decision"); "Memorandum Opinion and Order," 84 F.C.C.2d 50 (1980) (hereinafter referred to as "Computer II Memorandum Opinion and Order"); "Memorandum Opinion and Order on Further Reconsideration," 88 F.C.C.2d 512 (1981) (hereinafter referred to as "Computer II Reconsideration Order").

2 *Computer and Communications Industry Association v. Federal Communications Commission*, 693 F.2d 198 (D.C. Cir. 1982).

3 47 C.F.R. 64.702.

4 *See* Notice of Inquiry and Proposed Rulemaking in Second Computer Inquiry, 61 F.C.C.2d 103, 108 (1976).

5 *Id.* at 105.

so as to eliminate ambiguities.[6] Subsequent notices, and a tentative decision issued in 1979, indicated that the rulemaking proceeding continued to examine the definitional demarcation between data processing and communications.[7]

In its Final Decision released May 2, 1980, the FCC abandoned its attempt to distinguish communications from data processing services.[8] It decided to deregulate the provision of all enhanced services.[9] In addition, the FCC determined that "customer-premises equipment," the equipment that receives and sends messages and may perform services on the customer's premises, such as an ordinary telephone, an office switchboard, or a sophisticated telecommunications receiver, should be freed from regulation.[10] To accomplish this objective, state power to tariff this equipment was preempted.[11] This action was reaffirmed in the Memorandum Opinion and Order issued December 30, 1980.[12]

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6 *Id.* at 108.

7 Supplemental Notice of Inquiry and Enlargement of Proposed Rulemaking in Second Computer Inquiry, 64 F.C.C.2d 771 (1977). Tentative Decision and Further Notice of Inquiry and Rulemaking in Second Computer Inquiry, 72 F.C.C.2d 358 (1979).

8 Computer II Final Decision, 77 F.C.C.2d 384, 386-87 (1980).

9 *Id.*

10 *Id.* at 388, 455.

11 *Id.*

12 *See* Computer II Memorandum Opinion and Order, 84 F.C.C.2d 50, 103-05 (1980).

3. Regulatory context of the preemption decision.

The FCC forbearance from rate regulation of enhanced services and terminal equipment is not a significant departure from past practice as far as federal tariff regulation is concerned. The FCC has never established the tariffs for most enhanced services, nor have federal tariffs existed for most of the customer premises equipment provided to consumers by common carriers. The establishment of these rates has historically been the prerogative of state regulatory agencies.[13]

Much of the plant devoted to communications service in this country has both an intrastate and interstate use. Thus, a piece of customer premises equipment may be used primarily for intrastate calls in the local exchange and intrastate toll calls, but it may also be used for interstate toll calls. A similar joint use is made of the inside wiring on the customer's premises, the wiring that connects customers to switching facilities, the switching facilities, central office equipment, and other plant. Under the provisions of the Communications Act (47 U.S.C. §221(c)) and the decision of this Court in *Smith v. Illinois Bell Telephone Co.*,[14] a fair apportionment is required of the costs attributable to each jurisdiction in order to fairly account for these costs.[15] Over time, a separations process developed to accomplish this objective. Of the joint costs, which are apportioned in

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13 As the FCC recognized, it has historically set rates only for customer premises equipment used exclusively for interstate communications. Computer II Memorandum Opinion and Order, 84 F.C.C. 2d at 66-67.

14 282 U.S. 133, 51 S.Ct. 65 (1930).

15 *Id.* at 148, 51 S.Ct. at 68.

part according to the use of the facilities, the majority have been assigned to the intrastate jurisdictions.[16]

While the costs associated with jointly used customer premises equipment are divided between the state and federal jurisdictions, the responsibility for tariffing this equipment has always rested with the state regulatory agencies. Thus, the FCC recognized that the only federal tariffs for customer premises equipment involve equipment used exclusively in "interstate or foreign communications"[17] and that all customer premises equipment subject to the separations process is "tariffed at the state level."[18] The costs assigned to the federal jurisdiction for this equipment and other jointly used plant historically have been recovered in interstate toll telephone rates, not in any federal tariffs for jointly used equipment or plant. The federal "regulation" of the jointly used equipment has included the adjustment and the quantification of these interstate costs in determining the proper level of toll rates, but has not involved the tariffing of the equipment.

The FCC in its Final Decision recognized that customer premises equipment is "used *predominantly* in intrastate communications."[19] Nevertheless, the power to tariff this

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16 Certain issues relating to the separations process are discussed by the Louisiana Supreme Court in *South Central Bell Telephone Co. v. Louisiana Public Service Commission*, 352 So.2d 964, 981-85 (La. 1977). *See also* Computer II Memorandum Opinion and Order, 84 F.C.C.2d at 66.

17 Computer II Memorandum Opinion and Order, 84 F.C.C.2d at 67.

18 *Id.* at 66.

19 Computer II Final Decision, 77 F.C.C.2d at 456.

equipment was preempted. The FCC noted that the states "may no longer be able to regulate, as they have in the past, the charges for [customer premises] equipment used jointly in the provision of intrastate and interstate services."[20] The decision thus has the effect of rendering " 'meaningless' the jurisdiction of the State to establish charges for intrastate use of facilities . . . ."[21]

4. Grounds cited as supporting the decision to prohibit rate regulation of customer premises equipment by the states.

Historically, communications common carriers have operated under the discipline of state regulatory commissions. These agencies have granted "natural monopoly" status to these companies and the assurance of a "fair" return on investment, permitting the carriers to acquire substantial economic power over time. Simultaneously, state regulatory agencies exercise the power to protect consumers through the ratemaking process. As Professor Priest indicates in his treatise, "[every] state has . . . established a regulatory agency" and "the early predicates for regulation were developed under the guidance of state tribunals."[22] The ratemaking process is designed to set utility prices at a level that will allow only a fair rate of return to the utility.[23] The overriding principle is the "protection of the public interest."[24]

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20 *Id.* at 455.

21 *Id.* at 457.

22 1 A. Priest, *Principles of Public Utility Regulation* 25 (1969).

23 *Id.* at 191 *et seq.*

24 *Id.* at 193.

The decision to preempt state ratemaking authority was based largely on the determination of the FCC that the possible emergence of "competition" in markets for customer premises equipment *might* provide an adequate substitute for regulation. The FCC did not determine that competition exists in these markets. Instead, it prognosticated that competitive markets may develop. Thus, the FCC stated that "terminal equipment [customer premises equipment] markets can be workably competitive so long as restraints on competition are not tolerated,"[25] there are "likely competitive trends in the terminal equipment market,"[26] the market has "competitive potential,"[27] and the market "is subject to an increasing amount of competition . . . ."[28] These and similar comments were the basis for forbidding the rate regulation of customer premises equipment throughout the United States.

The conclusions of the FCC as to the possible competitive nature of the terminal equipment market are sharply contradicted by its own analysis relating to the requirement that the American Telephone & Telegraph Company ("AT&T") provide customer premises equipment through a separate subsidiary. As an indication of the power of AT&T, the FCC found that the Bell System receives more than eighty-one per cent of the total telephone revenue in the United States.[29] These receipts are about ten times

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25 **Computer II Final Decision, 77 F.C.C.2d at 454.**

26 *Id.* **at 454-55.**

27 *Id.* **at 440.**

28 *Id.* **at 439**

29 **Computer II Final Decision, 77 F.C.C.2d at 471.**

the revenues of the second place company, General Telephone & Electronics Corporation ("GTE"), and more than thirty times larger than the revenues of any other telephone company.[30]

The Bell System and GTE were subjected to structural separation because they have "sufficient market power to engage in anti-competitive activity on a national scale . . .,"[31] though the separation requirement was later removed from GTE.[32] Other firms offering terminal equipment and enhanced services are not operating nationwide because the markets are "infant yet promising . . . ."[33] Only two telephone companies, the Bell System and GTE, "have basic manufacturing operations producing large quantities of a wide range of telephone equipment."[34] On a national scale these companies have "substantial market positions, if not market power, in the provision of certain kinds of [customer premises equipment]."[35]

On a local level, the FCC determined that the Bell System and GTE have monopoly status. It referred to their "local monopoly positions [providing] the opportunity (without maximum separation) to engage in . . . anticompetitive conduct . . . ."[36] As the FCC stated, "[t]he importance

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30 *Id.*

31 *Id.* at 469.

32 Computer II Memorandum Opinion and Order, 84 F.C.C.2d at 72.

33 Computer II Final Decision, 77 F.C.C.2d at 467.

34 *Id.* at 473.

35 *Id.* at 467.

36 *Id.* at 473.

of the control of local facilities, as well as their location and number, cannot be overstated."[37]

The convincing demonstration by the FCC of the dominant position of the Bell System did not occur in the context of an analysis of the potential impact on consumers of the deregulation decision. Instead, this discussion was deemed relevant only to the structural determinations necessary to properly handicap the future participants in the customer premises equipment market. However, the discussion shows that customer premises equipment will not be available in the near future in a true "competitive market." Instead, this equipment will be provided by "carriers having significant market power and the ability to exercise it to the detriment of the communications ratepayer . . . ."[38] The FCC did not attempt to determine the extent to which "competition" has emerged in local markets in different states throughout the country.

5. Decisions of the FCC and the court of appeals.

The decision of the FCC reflects a determination that (1) it need not exercise regulatory jurisdiction over customer premises equipment and (2) it can preclude the states from doing so. On the first issue, the FCC held that enhanced services are outside its jurisdiction under Title II of the Communications Act.[39] Thus, they cannot be regulated at the federal level. In addition, it found that it has " 'permissive authority' " over customer premises equipment and that

37 *Id.* at 468.

38 *Id.* at 486.

39 Computer II Memorandum Opinion and Order, 84 F.C.C.2d at 89-90.

"the Act does not mandate its regulation."[40] Therefore, the "forbearance from its regulation" assertedly is not unlawful.[41] On the preemption issue, the FCC held that its "authority over terminal equipment"[42] was sufficient to require the states to adhere to the forbearance from regulation. Thus, the FCC found that under the preemption doctrine, it could abstain from exercising jurisdiction and at the same time preclude the states from exercising their regulatory authority.

The court of appeals held that the FCC was correct in finding that customer premises equipment "is not within the scope of Title II" of the Communications Act.[43] Therefore, it sustained the decision "not to subject enhanced services or CPE to Title II regulation . . . ."[44] However, the court found that the FCC could exercise "ancillary" jurisdiction to require that customer premises equipment be detariffed.[45] This exercise of " 'elastic' " power was deemed necessary to accommodate " 'dynamic new developments in the field of communications' " and eliminate any need for

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40 *Id.* at 99, 100.

41 *Id.* at 99.

42 *Id.* at 103.

43 *Computer and Communications Industry Association v. Federal Communications Commission*, 693 F.2d 198, 209 D. C. Cir. (1982) ("Computer II Court of Appeals Decision.")

44 *Id.* at 209.

45 *Id.* at 211.

" 'repetitive' " authorizing legislation from Congress.[46] The court affirmed the preemption of state power, summarizing its decision as follows:

> We believe that Congress has empowered the Commission to adopt policies to deal with new developments in the communications industry and that the policy favoring regulation by marketplace forces embodied in Computer II is neither arbitrary, capricious nor an abuse of discretion. With this holding our review of the wisdom of state preemption is at an end.[47]

6. Impact of the antitrust settlement between the United States Department of Justice and AT&T.

In 1982, the United States Department of Justice and AT&T announced a settlement of the antitrust suit that was pending against the company. This settlement, as approved by the district court in which the case was pending, requires the divestiture by AT&T of the operating companies in the Bell System.[48] AT&T will be permitted to market customer premises equipment, as will the operating companies.

The antitrust settlement does not attempt to preempt state ratemaking power. If the states choose to regulate the marketing of customer premises equipment by the companies formerly comprising the Bell System and by other communications common carriers, they are prevented from

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46 *Id.* at 213, *citing General Telephone Co. of the Southwest v. United States*, 449 F.2d 846, 853 (5th Cir. 1971).

47 693 F.2d at 217.

48 *United States v. Western Electric Co.*, 1982-2 Trade Cas. (CCH) ¶64,900 (D.D.C. 1982).

doing so only by the Computer II decision. Thus, the preemption issue is fully presented in the context of this case.

REASONS FOR GRANTING THE WRIT

The Court should issue a writ of certiorari to determine whether a federal administrative agency may engage in "self-starting" preemption, in which traditional regulatory laws of the states are eviscerated to further a new agency "policy" that is beyond the explicit or implicit reach of any federal statute and contrary to the longstanding division of federal and state regulatory responsibilities. This issue arises in the context of a decision that attempts a drastic reordering of federal-state relations.

The ruling of the FCC and the court of appeals would prevent the states from setting rates for equipment that is used primarily in the intrastate jurisdictions, for which costs have been recovered primarily in the intrastate jurisdictions, and for which rates have been established exclusively in the intrastate jurisdictions. It precludes the determination by the states of the proper regulatory methods of protecting consumers in light of local conditions, including local determinations regarding the extent to which "competition" will curb the abuse of monopoly power. Though the states for decades have permitted the growth of "natural monopolies" in the communications industry only because they could also assure the fairness of rates through the regulatory process, this check on the power of communications providers is now eliminated.

The decision should be reviewed because it runs counter to the prior decisions of this Court. According to the court of appeals, preemption by an administrative agency is proper so long as Congress contemplated that the agency might

make up an unspecified new policy and the new policy is neither "arbitrary, capricious, nor an abuse of discretion."[49] The preemption of state power to accomplish the new policy is deemed valid without further inquiry.[50] This approach runs counter to precedents restricting the exercise of the preemption power through the requirement that the preemption be necessary to further a policy adopted by Congress.[51]

Furthermore, the decision of the court of appeals requires review because the statutes enacted by Congress show an explicit intention to reserve regulatory autonomy to the states. Indeed, specific provisions of the Communications Act were drafted to prevent the FCC from interfering with ratemaking prerogatives of the states. Prior to the Computer II decision, the federal-state application of the Congressional directive resulted in ratemaking autonomy for the states and the limitation of FCC ratemaking activities to the interstate realm. The departure from this division of power by an administrative agency, through the device of ignoring Congressional intent, should be subject to the review of this Court.

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49 Computer II Court of Appeals Decision, 693 F.2d at 217.

50 *Id.*

51 *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 83 S.Ct. 1210 (1963); *State of North Carolina v. United States*, 325 U.S. 507, 65 S.Ct. 1260 (1945).

I. A WRIT SHOULD BE ISSUED TO DETERMINE WHETHER PREEMPTION BY A FEDERAL AGENCY IS PERMISSIBLE TO FURTHER POLICIES NOT MANDATED BY STATUTE, BUT WHOLLY CREATED BY THE AGENCY.

The decision of the court of appeals recognized that the deregulation ruling of the FCC was a departure from principles set forth in the Communications Act. Indeed, a primary issue reviewed by the court of appeals was whether this new approach is so inconsistent with the law as to be impermissible in itself.[52] The FCC determined *not* to exercise the regulatory authority granted by statute, but instead to adopt a wholly new approach based on its asserted ancillary jurisdiction.[53] This approach included (a) forbearance from the cost-determination regulation previously exercised by the FCC; (b) the imposition of certain structural requirements on AT&T; and (c) the prohibition of traditional rate regulation of customer premises equipment and enhanced services by the states. The policy to be furthered, the deregulation of certain activities of common carriers, is not even remotely suggested as a goal of the Communications Act.[54] It was wholly created by the FCC.

This self-generating determination of federal policy by an administrative agency presents special problems when the fulfillment of the policy requires wholesale preemption of state authority. It is one thing for the court of appeals

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52 Computer II Court of Appeals Decision, 693 F.2d 198, 209.

53 *Id.* at 211-12.

54 *See* 47 U.S.C. §§201-222.

to hold that an agency has discretion to abstain from performing the duties outlined in a statute;[55] it is another to conclude that this agency's reversal of Congressional policy can also be imposed by the agency on the states. Yet the court of appeals affirmed the decision of the FCC on the ground that the agency policy was permissible under the statute and was not otherwise "arbitrary, capricious [or] an abuse of discretion."[56] This standard for the review of preemption actions taken to fulfill a self-generated agency policy runs counter to the decisions of this Court indicating that an express or implied Congressional directive is necessary for the preemption of state law. Therefore, a writ should be issued to review the decision.

Although Congress generally has the power to preempt state law pursuant to the Commerce Clause[57] and the Supremacy Clause[58] of the United States Constitution, considerations of federalism embodied in the Tenth Amendment have led the Court to require a clear showing that Congress intended preemption before invalidating state law. Thus, federal regulations are not deemed preemptive unless Congress unmistakably ordains this result.[59] Before preemption by an administrative agency will be approved, the agency must show that each element of its action furthers a Congressional objective.[60] This standard was not met by the

55 693 F.2d at 210-11.

56 *Id.* at 217.

57 U.S. Const. art. I, §8, cl. 3.

58 U.S. Const. art. VI, cl. 2.

59 *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 146-47, 83 S.Ct. 1210, 1219 (1963).

60 *State of North Carolina v. United States*, 325 U.S. 507, 65 S.Ct. 1260 (1945).

FCC, nor was it applied by the court of appeals.

In *Florida Lime and Avocado Growers, Inc. v. Paul*,[61] this Court reviewed a claim that federal standards applicable to the marketing of avocados should be deemed preemptive of inconsistent regulations in California. The Court held that preemption does not occur unless (1) the nature of the regulated subject matter permits no conclusion except that Congress intended preemption, or (2) in explicit terms, the "Congress has unmistakably so ordained."[62]

Paul held that the nature of the subject matter did not make preemption inevitable, since avocado regulation was "not a subject by its very nature admitting only of national supervision,"[63] nor "a subject demanding exclusive federal regulation in order to achieve uniformity vital to national interests . . . ."[64] The Court observed: "On the contrary, the maturity of avocados is a subject matter of the kind this Court has traditionally regarded as properly within the scope of state superintendence."[65]

On the question of Congressional purpose, the Court in *Paul* applied the rule requiring an unambiguous Congressional mandate. It stated:

> The settled mandate governing this inquiry, in deference to the fact that a state regulation of this kind is an exercise of the "historic

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61 373 U.S. 132, 83 S.Ct. 1210 (1963).

62 373 U.S. at 142, 83 S.Ct. at 1217 (citation omitted).

63 *Id.* at 143, 83 S.Ct. at 1218 (citation omitted).

64 *Id.* at 144, 83 S.Ct. at 1218 (citation omitted).

65 *Id.*

> police powers of the States," is not to decree such a federal displacement "unless that was the clear and manifest purpose of Congress . . . ." In other words, we are not to conclude that Congress legislated the ouster of this California statute by the marketing orders in the absence of an unambiguous congressional mandate to that effect. We search in vain for such a mandate.[66]

Thus, preemption should not be decreed unless the subject matter is a type permitting only national regulation or Congress has unmistakably decreed this result.

When a federal administrative agency takes an action resulting in the preemption of state law, the action can only be valid if it satisfies the prerequisites for the exercise of preemptive power by Congress. The power of administrative agencies is derived from statutes and the basis for the power to preempt must be provided by Congress.[67] In addition, the administrative agency is required to demonstrate conclusively that its actions further objectives mandated by Congress. Thus, in *State of North Carolina v. United States,*[68] which involved the Interstate Commerce Act, the Court overruled a decision of the Interstate Commerce Commission to supplant a state rate where it was not clearly shown that the decision furthered the purpose of the Con-

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66 373 U.S. at 146, 83 S.Ct. at 1219 (citation omitted).

67 *State of North Carolina v. United States,* 325 U.S. 507, 65 S.Ct. 1260 (1945).

68 325 U.S. 507, 65 S.Ct. 1260 (1945).

gressional legislation.[69] The Court stated:

> A scrupulous regard for maintaining the power of the state in this field has caused this Court to require that Interstate Commerce Commission orders giving precedence to federal rates must meet "a high standard of certainty." . . . Before the Commission can nullify a state rate, justification for the "exercise of the federal power must clearly appear." . . . And the intention to interfere with the state's ratemaking function is not to be presumed . . . , nor must its intention in this respect be left in serious doubt. . . . The foregoing cases also stand for the principle that the Interstate Commerce Commission is without authority to supplant a state-prescribed intra-state rate unless there are clear findings, supported by evidence, of each element essential to the exercise of that power by the Commission. . . .[70]

These authorities establish that preemptive intent must flow from Congress. Moreover, the intent is not easily inferred, but must be unmistakably ordained in the Congressional directive. Furthermore, when an administrative agency attempts preemption, it must provide clear findings linking each element of its action to the asserted Congressional authorization.

These standards have not been met in this case. Applying

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69 325 U.S. at 510-11, 65 S.Ct. at 1263.

70 *Id.* at 511, 65 S.Ct. at 1263 (citations omitted).

an "arbitrary, capricious [or] an abuse of discretion"[71] test, the court of appeals approved a wholesale preemption order designed not by Congress to further a policy mandated by it, but by an administrative agency to replace that agency's statutory duties. Because the decision runs counter to the principles historically applied by this Court, a writ of certiorari should issue to review it.

II. THE COURT SHOULD ISSUE A WRIT TO DETERMINE WHETHER AGENCY PREEMPTION IS PROPER IN THE FACE OF CONGRESSIONAL DIRECTIVES GRANTING AUTONOMY TO THE STATES IN THE AREA SUBJECT TO THE PREEMPTIVE ACTION.

The preemption of state power to tariff customer premises equipment and enhanced services is contrary to the language and intent of the Communications Act, which reserves this authority to the states. In addition, this action runs counter to the allocation of regulatory responsibility that has prevailed for half a century pursuant to the directives contained in the Act and a leading decision of this Court.[72] Therefore, a writ should issue to review the decision.

Section 152 of the Communications Act gives the FCC jurisdiction over "all interstate . . . communication by wire or radio . . . ."[73] However, this section excludes FCC jurisdiction over intrastate communications. Section

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71 Computer II Court of Appeals Decision, 693 F.2d at 217.

72 *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 149, 51 S.Ct. 65, 69 (1930).

73 47 U.S.C. §152(a).

152(b) states in part:

> [S]ubject to the provision of section 301 of this title, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . .[74]

In addition, Section 221(b) excludes from the jurisdiction of the FCC the power to set rates for jointly used equipment if the equipment is regulated by a state commission or other local authority. It provides:

> Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to . . . wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.[75]

These provisions establish the Congressional intention to preserve state ratemaking authority over jointly used terminal equipment. This view is also supported by the legislative

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74 47 U.S.C. § 152(b).

75 47 U.S.C. §221(b).

history of the Act. In enacting the Act, Congress denied the FCC the kind of jurisdiction over local rates that had been exercised by the Interstate Commerce Commission in a transportation context in the *Shreveport Rate Case*.[76] Under the "Shreveport doctrine," the ICC was permitted to suspend an intrastate rate in order to correct an alleged discriminatory relationship between interstate and intrastate rates.[77]

Section 221 (b) was included in the law at the suggestion of state regulators who were fearful that, in the absence of this language, the FCC might have the power to "override and interfere with State regulations."[78] Rep. Rayburn, who introduced the bill in the House of Representatives, said that Section 221 (b) "leaves local exchange service to local regulators even where a portion of such local exchange service constitutes interstate communications."[79]

The statutory provisions reserving ratemaking power over jointly used equipment to the states are also consistent with other provisions of the Communications Act and the practical division of power existing for the past five decades. Congress intended that the states set rates for intrastate services

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76 *Houston, East & West Texas Railway v. United States*, 234 U.S. 342, 34 S.Ct. 833 (1914). This interpretation of the legislative history was endorsed even in *North Carolina Utilities Commission v. Federal Communications Commission*, 552 F.2d 1036 (4th Cir. 1977), which adopted a restrictive interpretation of the limitation embodied in §221(b).

77 *North Carolina Utilities Commission v. Federal Communications Commission*, 552 F.2d 1036, 1047 (4th Cir. 1977).

78 Statement of Sen. Dill, Chairman of the Senate Committee, *Hearings on S.2910 Before the Senate Committee on Interstate Commerce*, 73d Cong., 2d Sess. 156 (1934).

79 78 Cong. Rec. 10314 (1934).

and for all equipment used jointly for intrastate and interstate purposes and this power has traditionally been exercised by the states. The FCC, on the other hand, was given rate-setting power over interstate communications services – meaning long distance calls and messages.[80] Thus, the FCC was granted authority only to establish rates "for interstate and foreign wire or radio communication between . . . different points . . . ."[81]

In allocating this limited tariffing responsibility to the FCC, Congress was aware that most communications plant is jointly used for intrastate and interstate messages. Although it left to the states the power to tariff this equipment, Congress did provide for a fair division of the costs associated with this plant between the jurisdictions.

Thus, Section 221(c) of the Communications Act provides for the separation of "interstate" plant for the purpose of establishing the regulatory authority of the FCC. It states:

> For the purpose of administering this chapter as to carriers engaged in wire telephone communication, the Commission may classify the property of any such carrier used for wire telephone communication, and determine what property of said carrier shall be considered as used in interstate or foreign telephone toll service.[82]

Pursuant to this provision, a process for "separating" costs

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80 47 U.S.C. §§152(a) & (b), 203, and 221 (b) & (c).

81 47 U.S.C. §203(a).

82 47 U.S.C. §221(c).

arose and has been in use for decades.[83] The costs assigned to the federal jurisdiction are recovered in interstate toll rates. The costs assigned to the states have been recovered in the rates for customer premises equipment and other services. The provision for the division of costs among the jurisdictions implements the decision of this Court in *Smith v. Illinois Bell Telephone Co.*,[84] which requires a fair division of costs.

The provision for the separation of jointly used plant establishes that Congress was well aware that the local plant of telephone companies was partially used for interstate communications. This local plant was rate regulated by the state commissions, except for the rates applicable to interstate toll services, and Congress intended that this approach continue. Congress in Section 203 authorized the FCC to provide tariffs for interstate communications services,[85] thereby filling the regulatory void resulting from the jurisdictional limits applicable to state agencies. Congress did *not* grant power to the FCC over tariffs for intrastate services, including the various components of basic local exchange service. This authority was reserved to the states and was not threatened for nearly half a century, prior to the adoption of the *Computer II* decision.

The specific language of the Communications Act, its legislative history, the overall plan it embodies for the apportionment of regulatory responsibilities in the federal system,

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83 *See* NARUC-FCC Separations Manual.

84 282 U.S. 133, 149, 51 S.Ct. 65, 69 (1930).

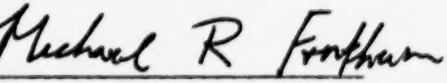
85 47 U.S.C. § 203.

and its implementation since 1934, establish the Congressional intent to reserve to the states ratemaking authority over jointly used customer premises equipment. No change in this approach has been decreed by Congress. Therefore, a writ of certiorari should be issued to determine whether agency preemption is proper in the face of a Congressional directive preserving the autonomy of the states in the area that the agency seeks to preempt.

CONCLUSION

This case involves a drastic reordering of federal-state regulatory prerogatives. The preemptive action of the FCC was taken to implement a new policy not created by Congress. but fashioned by the agency without any explicit or implicit Congressional directive. In addition, the intrusion into an area traditionally occupied by the states runs counter to the provisions of the Communications Act. A writ should be issued to determine whether preemption is proper to implement a self-generated plan of an administrative agency where Congress has granted autonomy to the states in the area that is the subject of the preemptive action.

Respectfully submitted,



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Attorneys for Petitioner

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1471

COMPUTER AND COMMUNICATIONS INDUSTRY ASSOCIATION,
PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA, RESPONDENTS

NORTH AMERICAN TELEPHONE ASSOCIATION,
UTILITIES TELECOMMUNICATIONS COUNCIL,
TYMNET, INC.,
CONTINENTAL TELEPHONE CORPORATION,
XEROX CORPORATION,
HAZELTINE CORPORATION,
ALARM INDUSTRY TELECOMMUNICATIONS COMMITTEE OF THE NATIONAL BURGLAR & FIRE ALARM ASSOCIATION,
RCA GLOBAL COMMUNICATIONS, INC.,
SATELLITE BUSINESS SYSTEMS,
MOTOROLA, INC.,
U.S. TELEPHONE & TELEGRAPH CORPORATION,
AMERICAN PETROLEUM INSTITUTE,
CITICORP,
CENTRAL TELEPHONE & UTILITIES CORPORATION,
COMSAT GENERAL CORPORATION,
AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION,
GTE SERVICE CORPORATION,

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

SPERRY UNIVAC DIVISION OF SPERRY CORPORATION,
COMMUNICATIONS SATELLITE CORPORATION,
INTERNATIONAL BUSINESS MACHINES CORPORATION,
AMERICAN TELEPHONE & TELEGRAPH COMPANY,
COMPUTER & BUSINESS EQUIPMENT MANUFACTURERS ASSOCIATION,
CONTROL DATA CORPORATION,
UNITED TELEPHONE SYSTEM, INC.,
UNITED COMPUTING SYSTEMS, INC.,
SOUTHERN PACIFIC COMMUNICATIONS COMPANY,
WESTERN UNION TELEGRAPH COMPANY,
AERONAUTICAL RADIO, INC.,
ISA COMMUNICATIONS SERVICES, INC.,
INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION, INC.,
ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS, INC.,
BUNKER RAMO CORPORATION,
GTE TELENET COMMUNICATIONS CORPORATION,
MUNICIPALITY OF ANCHORAGE d/b/a ANCHORAGE TELEPHONE UTILITY,
LOUISIANA PUBLIC SERVICE COMMISSION, INTERVENORS

No. 81-1193

THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

No. 81-1217

INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION, INC., PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

No. 81-1222

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

No. 81-1223

DATAPOINT CORPORATION, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

No. 81-1224

AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

No. 81-1226

MOTOROLA, INC., PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

INTERNATIONAL BUSINESS MACHINES CORP., *et al.*, INTERVENORS

Petitions for Review of Orders of the Federal Communications Commission

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Argued March 22, 1982

Decided November 12, 1982

John H. Chapman and *Herbert E. Marks*, with whom *Laurel R. Bergold*, *Bernard M. Beerman*, *Brian E. Moran*, and *Daniel A. Huber* were on the joint briefs, for petitioners Computer and Communications Industry Association and Independent Data Communications Manufac-

turers Association, Inc., and intervenors Association of Data Processing Service Organizations, Inc., Alarm Industry Telecommunications Committee of the National Burglar & Fire Alarm Association, and Southern Pacific Communications Company.

Deborah A. Dupont, Deputy Assistant General Counsel, National Association of Regulatory Utility Commissioners (NARUC), with whom *Charles D. Gray*, Assistant General Counsel, NARUC, *Janice E. Kerr*, *J. Calvin Simpson*, and *Gretchen Dumas*, Attorneys, Public Utilities Commission of the State of California, and *Michael R. Fontham* were on the briefs, for petitioners NARUC, State of California, and Public Utilities Commission of the State of California, and for intervenor Louisiana Public Service Commission.

Michael Yourshaw, with whom *Aloysius B. McCabe*, *Kevin R. Jones*, *Robert J. Butler*, *W. Terry Maguire*, and *Pamela Riley* were on the brief, for petitioner/intervenor American Newspaper Publishers Association (ANPA). *Douglas R. Watts* and *Rodney L. Joyce* also entered appearances for ANPA.

John N. McCamish, Jr., and *Andrew S. Viger* were on the brief for petitioner Datapoint Corporation.

John L. Bartlett, *Danny E. Adams*, *Susan Patrick Inzeo*, *Michael Yourshaw*, *Howard D. Polsky*, and *John F. Lyons* were on the brief for petitioner/intervenor Motorola, Inc.

N. Frank Wiggins, with whom *Edwin B. Spievack*, *David M. Rickless*, and *Victor J. Toth* were on the brief, for intervenors North American Telephone Association (NATA) and Wisconsin Telecommunications Contractors Association (WTCA). *Ian D. Volner* also entered an appearance for NATA and WTCA.

James H. Laskey, Attorney, U.S. Department of Justice, with whom *Barry Grossman*, Attorney, U.S. Department of Justice, was on the brief, for respondent USA.

John E. Ingle, Deputy Associate General Counsel, Federal Communications Commission (FCC), with whom *Stephen A. Sharp*, General Counsel, *Daniel M. Armstrong*, Associate General Counsel, *Jane E. Mago*, and *Michael D. Sullivan*, Counsel, FCC, were on the brief, for respondent FCC. *Jack David Smith*, Counsel, FCC, also entered an appearance for respondent FCC.

Joseph Mordecai Kittner, with whom *Carl R. Ramey, Edward P. Taptich, Lawrence J. Movshin*, and *John S. Voorhees* were on the brief, for intervenor Computer & Business Equipment Manufacturers Association (CBEMA). *Virginia S. Carlson* also entered an appearance for CBEMA.

Michael Boudin, with whom *J. Mark Iwry, Carolyn F. Corwin, Alfred A. Green*, and *Howard J. Trienens* were on the brief, for intervenor American Telephone & Telegraph Company (AT&T). *Stuart A. Stock* also entered an appearance for AT&T.

J. Roger Wollenberg, with whom *David R. Anderson, William T. Lake, Roger M. Witten, Jane Tucker Dana*, and *Jonathan Becker* were on the brief, for intervenor IBM Corporation.

James R. Hobson was on the brief for intervenors GTE Service Corporation and GTE Telenet Communications Corporation. *Philip M. Walker, Donald E. Ward, William R. Malone*, and *Richard McKenna* also entered appearances for intervenor GTE Telenet Communications Corporation.

Joseph P. Markoski was on the brief for intervenor Honeywell, Inc. *Thomas J. Gallagher* also entered an appearance for Honeywell, Inc.

Arthur B. Sackler was on the brief for intervenor National Newspaper Association.

Bernard M. Beerman and *Brian E. Moran* were on the brief for intervenor Alarm Industry Telecommunica-

tions Committee of the National Burglar & Fire Alarm Association (AITC).

Stephen R. Bell entered an appearance for intervenor Tymnet, Inc.

Charles M. Meehan and *Shirley S. Fujimoto* entered appearances for intervenor Utilities Telecommunications Council.

Thomas L. Jones and *John Wohlstetter* entered appearances for intervenor Continental Telephone Corporation.

John R. Murphy and *Lawrence W. Secrist, III*, entered appearances for intervenor Xerox Corporation.

Lawrence M. DeVore entered an appearance for intervenor Communications Satellite Corporation.

John B. Gantt entered an appearance for intervenor COMSAT General Corporation.

Alan Raywid entered an appearance for intervenor Sperry Univac Division of Sperry Corporation.

Victor E. Ferrall, Jr., and *Linda K. Smith* entered appearances for intervenors Control Data Corporation and Hazeltine Corporation.

John M. Lathschuetz, Carolyn C. Hill, and *John W. Hunter* entered appearances for intervenor United Computing Systems, Inc. and United Telephone Systems, Inc.

John V. Kenny entered an appearance for intervenor Southern Pacific Communications Company.

Joel Yohalem entered an appearance for intervenor Western Union Telegraph Company.

John L. Bartlett entered an appearance for intervenor Aeronautical Radio, Inc.

Norman P. Leventhal entered an appearance for intervenor ISA Communications Services, Inc.

Tedson J. Meyers, Michael W. Faber, and *Robert J. Miller* entered appearances for intervenors Bunker Ramo Corporation and Citicorp.

Michael L. Glaser, Kathy J. Bible, and *Francis E. Fletcher, Jr.,* entered appearances for intervenor Municipality of Anchorage d/b/a Anchorage Telephone Utility.

Theodore D. Frank entered an appearance for intervenor Central Telephone & Utilities Corporation.

Wayne V. Black, Larry S. Solomon, Stark Ritchie, and *David E. Lindgren* entered appearances for intervenor American Petroleum Institute.

John A. Ligon entered an appearance for intervenor U.S. Telephone & Telegraph Corporation.

William D. English, Harold David Cohen, and *Jack N. Goodman* entered appearances for intervenor Satellite Business System.

Alexander P. Humphrey, IV, entered an appearance for intervenor RCA Global Communications, Inc.

William J. Byrnes, John M. Pelkey, and *Ruth S. Baker Battist* entered appearances for intervenor MCI Telecommunications Corporation.

Stephen M. Feldman entered an appearance for intervenor American Business, Press, Inc.

Nathan M. Norton, Jr., Chairman, Arkansas Public Service Commission, was on the brief for *amicus curiae* State of Arkansas, urging that the FCC's decision be set aside.

Philip J. Mause, Norman A. Pedersen, and *Steven M. Schur* were on the brief for *amicus curiae* The Public Service Commission of Wisconsin, urging that the FCC's decision be set aside.

Horace S. Libby and *David Moskovitz* were on the brief for *amicus curiae* The Maine Public Utilities Commission, urging that the FCC's decision be set aside.

Carl L. Evans, Stanley W. Foy, and *Gary A. Tomlin* were on the brief for *amicus curiae* Alabama Public Service Commission, urging that the FCC's order be reversed and remanded with instructions.

Henry Geller was on the brief for *amicus curiae* Henry Geller, urging affirmance.

Warren Spannaus, Attorney General of the State of Minnesota, was on the statement in lieu of brief for *amicus curiae* Department of Public Service of the State of Minnesota, urging that the FCC's decision be set aside.

Evan Wilner and *Sandra Minch Hodes* were on the statement in lieu of brief for *amicus curiae* Office of People's Counsel of Maryland, urging that the FCC's decision be set aside.

Donald A. Law, Assistant General Counsel for the State of Kansas, was on the brief for *amicus curiae* The State Corporation Commission of the State of Kansas, urging that the FCC's decision be set aside.

William B. Gundling and *Robert S. Golden, Jr.,* Assistant Attorneys General for the State of Connecticut, were on the statement in lieu of brief for *amicus curiae* Department of Public Utility Control of the State of Connecticut, urging that the FCC's decision be set aside.

Before TAMM and EDWARDS,* *Circuit Judges,* and JAMES F. GORDON,** *U.S. Senior District Judge* for the Western District of Kentucky.

Opinion for the court filed by *Circuit Judge* TAMM.

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* Circuit Judge Edwards did not participate in the disposition of this case.

** Sitting by designation pursuant to 28 U.S.C. § 294(d) (1976).

TAMM, *Circuit Judge*: This is a review of a Federal Communications Commission (Commission) rulemaking proceeding known throughout the telecommunications industry as the *Second Computer Inquiry* or simply *Computer II*.[1] Responding to monumental changes in the technological and economic conditions of the communications marketplace, the Commission in *Computer II* overhauled the regulatory regime governing the interrelationship of telecommunications and data processing. Eight petitioners and scores of intervenors challenge the Commission's new rules on myriad grounds. In our view, the Commission's action in adopting these rules was neither arbitrary nor capricious, nor did it constitute an abuse of discretion. We are convinced that the regulatory scheme established in *Computer II* is a reasonable one within the scope of the Commission's authority under the Federal Communications Act of 1934, 47 U.S.C. § 151 *et seq.* (1976) (the Act). Accordingly, we affirm the Commission's decision in its entirety.

I. BACKGROUND

The FCC first addressed the regulatory and policy problems posed by the growing interdependence of com-

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[1] The Federal Communications Commission (Commission) orders comprising the *Computer II* decision are as follows: Final Decision, *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 F.C.C.2d 384 (1980) (*Computer II Final Decision*); Memorandum Opinion and Order, *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 84 F.C.C.2d 50 (1980) (*Computer II Reconsidered Decision*); Memorandum Opinion and Order on Further Reconsideration, *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 88 F.C.C.2d 512 (1981) (*Computer II Further Reconsidered Decision*). These orders will be referred to by their designated short forms in the text and footnotes that follow.

munications and data processing in a proceeding known as the *First Computer Inquiry* or *Computer I*,[2] begun in 1966.[3] The proceeding culminated in 1971 with the adoption of rules delineating the circumstances in which computer use by common carriers constituted common carrier communication subject to regulation under Title II of the Act[4] and when such use constituted unregulated data processing.[5] Under the *Computer I* regime, the Commission looked at the manner in which computerization was employed to determine how a service would be regulated. To facilitate this functional approach, the Commission distinguished between communications services using com-

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[2] Tentative Decision of the Commission, *In re* Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities, 28 F.C.C.2d 291 (1970) (*Computer I Tentative Decision*); Final Decision and Order, *In re* Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities, 28 F.C.C.2d 267 (1971) (*Computer I Final Decision*), *aff'd in part and rev'd in part sub nom.* GTE Service Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973), *decision on remand*, 40 F.C.C.2d 293 (1973).

[3] *See* Notice of Inquiry, *In re* Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities, 7 F.C.C.2d 11 (1966); Supplemental Notice of Inquiry, *In re* Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities, 7 F.C.C.2d 19 (1967).

[4] The Communications Act of 1934, 47 U.S.C. § 151 *et seq.* (1976), is composed of three titles. Title I contains general provisions of the Act. *Id.* §§ 151-155. Title III provides for Commission regulation of broadcasting. *Id.* §§ 301-397. Title II, *id.* §§ 201-222, gives the Commission authority over common carrier interstate or foreign communication by wire or radio. The Commission has the power under Title II to adjudge the lawfulness of proposed charges, classifications, regulations, and practices, *id.* § 204, and if it finds them unlawful, to prescribe just and reasonable ones, *id.* § 205.

[5] These rules are found at 36 Fed. Reg. 5345, 5353-54 (1971).

puters to perform message or circuit switching, which were regulated, and data processing services, which were left to marketplace competition.[6] The regulatory status of "hybrid" services, which combined both communications and data processing functions, was to be determined on a case-by-case basis depending upon which function was predominant.[7]

In *Computer I* the Commission also set forth the conditions under which a common carrier could enter the data processing marketplace. The rules required "maximum separation" of a common carrier's communications activities from its unregulated data processing services.[8] This requirement was designed to prevent common carriers from unfairly burdening their regulated communications services with costs properly attributable to unregulated data processing services.[9]

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[6] The Commission defined data processing as "use of a computer for the processing of information as distinguished from circuit or message-switching." *Computer I Tentative Decision*, 28 F.C.C.2d at 295. "Message-switching" was defined as "[t]he computer-controlled transmission of messages, between two or more points, via communications facilities, wherein the content of the message remains unaltered." *Id.* at 296.

[7] *See Computer I Final Decision*, 28 F.C.C.2d at 276-79; *Computer I Tentative Decision*, 28 F.C.C.2d at 305.

[8] The "maximum separation" requirement meant that common carriers could offer data processing services only through a separate corporate entity having separate accounting records, personnel, and equipment and facilities. *See Computer II Final Decision*, 77 F.C.C.2d at 391 n.2.

[9] *Computer I Final Decision*, 28 F.C.C.2d at 270-71. The Commission forbade AT&T to offer data processing even through a separate subsidiary because the Commission then assumed that AT&T's 1956 consent decree, *see* discussion *infra* pages 45-47, precluded the company from offering data processing services. *Id.* at 282; *see Computer I Tentative Decision*, 28 F.C.C.2d at 298-99, 305.

The *Computer I* rules were sustained by the Second Circuit,[10] but even as they were being implemented, technological developments rendered them nearly obsolete.[11] As computer and communications technology continued to merge, the line between regulated and unregulated activities became increasingly blurred, and the *Computer I* definitions became unworkable.[12] In addition, both the data processing and the communications industries were becoming increasingly competitive[13] and therefore less

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[10] GTE Service Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973). Certain provisions involving regulation of data processing services were set aside. *Id.* at 732-36, 737.

[11] *See Computer II Final Decision*, 77 F.C.C.2d at 391-93.

[12] For example, technological advances made it possible for significant data processing functions to be performed in numerous computer terminals distributed throughout the communications network rather than in just one central computer. *See id.* It therefore became increasingly difficult to classify terminals and services as either communications or data processing. AT&T's proposal in 1975 to market a sophisticated terminal device, the Dataspeed 40/4, highlighted the problems inherent in the *Computer I* definitional approach. The Dataspeed 40/4 had data processing capabilities that enabled it to perform some functions that would have been performed in a central computer at the time the 1971 rules were adopted. Thus, many argued that the Commission should reject AT&T's proposal because it was offering a hybrid data processing service. Although the Commission ultimately classified the Dataspeed 40/4 as a communications service, it recognized the inadequacy of the 1971 rules for dealing with new technologies. *See In re* American Telephone and Telegraph Co. (AT&T), 62 F.C.C. 2d 21, 30-31 (1977), *aff'd sub nom.* International Business Machines Corp. v. FCC, 570 F.2d 452 (2d Cir. 1978). Between 1975, when the Dataspeed 40/4 was first offered, and 1977, when the Commission determined that the Dataspeed 40/4 was primarily a communications service, consumers were deprived of this valuable new technology.

[13] *See Computer II Final Decision*, 77 F.C.C.2d at 433-34.

susceptible to the type of abuses the Commission had sought to discourage through its *Computer I* rules.[14]

Thus, in 1976 the Commission instituted the *Second Computer Inquiry* to reexamine its definitional structure and to find a more workable regulatory approach.[15] Five years and thousands of pages of comments later, the Commission ended its study by making major changes in the regulatory regime. The Commission hopes that these changes will provide greater certainty and predictability of regulation for the subject companies and will enhance competition in communications and data processing.[16]

In *Computer II* the Commission abandoned the attempt to classify activities as either communications or data processing based on the nature of the processing per-

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[14] In the telecommunications marketplace, the increase in competition is, in part, a result of Commission decisions allowing customer premises equipment (CPE) provided by non-common carriers to be directly connected to the interstate communications network. Traditionally, common carriers limited access to their transmission services to customers with carrier-provided CPE. In its 1968 *Carterfone* decision, however, the Commission required carriers to provide access to transmission services to customers with non-carrier-provided CPE. Carterfone, 13 F.C.C.2d 420, *reconsid. denied*, 14 F.C.C. 2d 571 (1968); *see* Interstate and Foreign Message Toll Telephone, 56 F.C.C.2d 593 (1975), *clarified*, 59 F.C.C.2d 83 (1976), *aff'd sub nom.* North Carolina Utilities Comm'n v. FCC, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977); *see also Computer II Final Decision*, 77 F.C.C.2d at 439-40. CPE includes the basic telephone, answering machines, key systems, and PBX switchboards.

[15] *See* Notice of Inquiry and Proposed Rulemaking, *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations, 61 F.C.C.2d 103, 107 (1976) (*Notice of Inquiry*); *see also* Supplemental Notice of Inquiry and Enlargement of Proposed Rulemaking, *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer Inquiry), 64 F.C.C.2d 771 (1977) (*Supplemental Notice of Inquiry*).

[16] *Computer II Final Decision*, 77 F.C.C.2d at 423, 428-30.

formed. The respective technologies had become so intertwined, according to the Commission, that it had become impossible to draw an "enduring line of demarcation" between them.[17] In the course of its *Second Computer Inquiry*, the Commission concluded that the only clear and lasting distinction would be one between basic transmission service on the one hand and enhanced services and customer premises equipment (CPE) on the other.[18] According to the Commission, drawing the regulatory line in this way would minimize the type of ad hoc adjudication that had taken place under the 1971 rules.[19] In addition, such a distinction would make it possible to eliminate unneeded regulation and thereby promote efficient use of the telecommunications network.[20]

Under the *Computer II* scheme, the Commission continued to require common carriers to provide basic transmission services under tariff on an equal basis to all customers. The Commission found that enhanced services and CPE were not within the scope of its Title II juris-

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[17] *Id.* at 430.

[18] Basic service is the offering of "a pure transmission capability over a communications path that is virtually transparent in terms of its interaction with customer supplied information." *Id.* at 419-20. Enhanced service is any service other than basic service. Enhanced service "combines basic service with computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information, or provide the subscriber additional, different, or restructured information, or involve subscriber interaction with stored information." *Id.* at 387. An example of enhanced service is AT&T's Dial It service, whereby subscribers dial a certain number to gain access to stored information such as the scores of professional sports contests. *See Computer II Reconsidered Decision*, 84 F.C.C.2d at 55.

[19] *Computer II Final Decision*, 77 F.C.C.2d at 425, 434-35; *see* note 12 *supra*.

[20] *Computer II Final Decision*, 77 F.C.C.2d at 387.

diction but were within its ancillary jurisdiction.[21] Accordingly, the Commission discontinued Title II regulation of enhanced services and, with the exception of AT&T,[22] relieved common carriers of the "maximum separation" requirement upon which their offerings of enhanced services were conditioned under *Computer I*.[23] Similarly, the Commission "unbundled" CPE from basic transmission services by discontinuing rate regulation of CPE and ordering that CPE be sold separately from basic communications service in a competitive market.[24] The *Computer II* rules also required common carriers to keep separate accounts of their regulated basic service and their competitive services. Thus, the carriers must sell their basic service to themselves at the tariff rate when they provide enhanced services to their customers. These requirements were designed to prevent "cross-subsidization" of a carrier's unregulated services by its regulated services.[25]

The Commission declared that its regulatory policy respecting interstate facilities or services preempted in-

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[21] *Id.* at 431-35, 450-52; *see* notes 38-40 & 53-55 *infra* and accompanying text.

[22] Because of AT&T's pervasive market power, the Commission decided to permit it to offer enhanced services only through a separate subsidiary. Originally the Commission decided to also subject GTE to this separate subsidiary requirement, *Computer II Final Decision*, 77 F.C.C.2d at 474, but, on reconsideration, exempted GTE, *Computer II Reconsidered Decision*, 84 F.C.C.2d at 72.

[23] *Computer II Final Decision*, 77 F.C.C.2d at 388-89; *see* note 8 *supra*.

[24] *Computer II Final Decision*, 77 F.C.C.2d at 388-89.

[25] Cross-subsidization occurs when a carrier misattributes costs incurred in the provision of unregulated services to the provision of regulated services. Because rates for regulated services are based partially upon the cost of providing those services, misattribution of costs results in the carrier's monopoly ratepayers' bearing a part of the cost of unregulated services. *See id.* at 445, 476-77.

consistent state regulation of those services or facilities.[26] Although the Commission was careful to limit the area of preemption, some preemption of state regulation was deemed necessary because the same facilities are usually used for both interstate and intrastate communications.[27] For the federal program of deregulation to work, state regulation of CPE and enhanced services had to be circumscribed.[28]

During its proceedings, the Commission considered the effect of the proposed regulatory changes on AT&T's continued offering of CPE and enhanced services in light of a 1956 consent decree limiting AT&T to providing services that are "subject to public regulation" and activities "incidental" thereto.[29] The Commission recognized that it could not definitively construe the decree[30] but stated its view that AT&T's participation in the new regulatory scheme would be consistent with the decree.[31]

II. Analysis

The arguments supporting and challenging the *Computer II* decision are as numerous as the parties before this court. Seemingly, every argument ever made in an administrative law case is pressed here in some form. We

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[26] *Computer II Reconsidered Decision*, 84 F.C.C.2d at 104; *Computer II Further Reconsidered Decision*, 88 F.C.C.2d at 523-24, 541-42.

[27] *Computer II Final Decision*, 77 F.C.C.2d at 455-57.

[28] *Computer II Further Reconsidered Decision*, 88 F.C.C.2d at 541 n.34.

[29] United States v. Western Electric Co., 1956 Trade Cas. (CCH) ¶ 68,246, at 71, 137-38 (D.N.J. 1956); *see Computer II Reconsidered Decision*, 84 F.C.C.2d at 106.

[30] *Computer II Final Decision*, 77 F.C.C.2d at 492.

[31] *Computer II Reconsidered Decision*, 84 F.C.C.2d at 106; *see generally id.* at 105-09; *Computer II Final Decision*, 77 F.C.C.2d at 490-95.

consider it unnecessary to address all the arguments presented to us, and grounds for challenging the Commission's decision not mentioned herein should be considered rejected. We will, however, address four of the most controversial aspects of the Commission's decision.

First, many contend that the Commission erred in concluding that CPE and enhanced services are not appropriate subjects for Title II regulation. Others argue that in its *Computer II* orders the Commission gave an unsupportably expansive reading to its ancillary jurisdiction to regulate non-Title II activities.

Second, many parties—particularly the state regulatory commissions—view the Commission's preemption of inconsistent state regulation as an invasion of ratemaking authority reserved to the states under the Communications Act. These parties urge us to declare that the states continue to have authority to regulate CPE used jointly in interstate and intrastate commerce. In addition, these parties argue that the Commission failed to give adequate notice of its intention to preempt state regulation.

Third, some argue that the "maximum separation" requirement should have been imposed on other carriers in addition to AT&T. Various parties also believe that AT&T should have been subjected to tighter regulation than that contemplated under *Computer II*.

Finally, some parties contend that the Commission based its decision on a misinterpretation of the 1956 consent decree between AT&T and the United States. This issue has apparently been mooted by vacation of the consent decree as part of the recent settlement of the Justice Department's antitrust suit against AT&T. Nevertheless, we will address it briefly.

A. *The Deregulation of Enhanced Services and CPE*

The most fundamental challenge to the *Computer II* decision is the claim that the Commission has impermis-

sibly deregulated enhanced services, CPE, or both. Although framed in different ways by the various parties, the point of the argument is that the Commission is required to regulate carrier-provided enhanced services and CPE under Title II of the Act. We believe that the Commission's reading of the Act is supportable and that its concomitant regulatory scheme is a rational and amply explained policy choice.

We turn first to the Commission's treatment of enhanced services. Title II of the Act empowers the Commission to impose rate regulation only upon common carriers "engaged in interstate or foreign *communication* by wire or radio." [32] As the relationship between data processing and communications became increasingly close, the Commission decided in the *First Computer Inquiry* not to regulate the rates charged for data processing services.[33] This decision forced the Commission to evaluate case by case the character of new services combining data processing and communications to determine whether the new services were to be regulated.[34] By the time of the *Second Computer Inquiry*, this task had become practically impossible.[35] Consequently, the Commission was compelled to choose a new regulatory path to fulfill its statutory duty "to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and world-wide wire and radio communication service." [36]

Two paths were available to the Commission: regulate all combined data processing and communications services under Title II, or regulate none.[37] Electing the first path

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[32] 47 U.S.C. § 201(a) (1976) (emphasis added).

[33] *See Computer II Final Decision*, 77 F.C.C.2d at 390.

[34] *See id.*

[35] *Id.* at 393.

[36] 47 U.S.C. § 151 (1976).

[37] *Computer II Final Decision*, 77 F.C.C.2d at 428.

would have required the Commission to reverse its policy, established in *Computer I*, of not regulating data processing services and would also have required the Commission to confront the issue of its authority to exert Title II jurisdiction over data processing. Instead, the Commission chose the alternative course and decided not to impose Title II regulation on any combined data processing and communications services, which the Commission termed "enhanced services."

Although the Commission did not impose Title II regulation on enhanced services, it determined that it has ancillary jurisdiction over enhanced services under sections 152 and 153 of the Act. Section 152 gives the Commission jurisdiction over "all interstate and foreign communication by wire or radio," [38] and section 153 defines "communication by wire" as "the transmission of writing, signs, signals, pictures and sounds of all kinds . . . incidental to such transmission." [39] The Commission found that enhanced services fall within its ancillary jurisdiction as incidental transmissions over the interstate telecommunications network.[40]

Nevertheless, the Commission declined to institute a comprehensive regulatory scheme for enhanced services. Because the Commission found that the market for enhanced services is "truly competitive," [41] it believes that market forces will protect the public interest in reasonable rates and availability of services. Therefore, in the Commission's view, comprehensive regulation of enhanced services would not be permissible because it would not be "di-

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[38] 47 U.S.C. § 152(a) (1976).

[39] *Id.* § 153(a)-(b).

[40] *Computer II Final Decision*, 77 F.C.C.2d at 432.

[41] *Id.* at 433.

rected at protecting or promoting a statutory purpose." [42] The one exception to the Commission's policy of not regulating enhanced services is its imposition of a structural separation requirement on AT&T under which AT&T can offer enhanced services to consumers only through a separate subsidiary.

In dealing with CPE the Commission faced a dilemma similar to the one it confronted in the case of enhanced services. Traditionally, the Commission required CPE provided by common carriers to be included in the tariffs for their transmission services under Title II. This "bundling" of equipment charges into transmission rates was, in effect, Title II regulation of CPE, justified on the ground that equipment like the telephone handset was part of an "end-to-end" common carrier service.[43] In recent years, however, CPE has evolved from the "plain old telephone," which merely sends and receives communications signals, into sophisticated home computer terminals like the Dataspeed 40/4 [44] that incorporate both communications and data processing elements. Additionally, non-common carriers are now competitively furnishing CPE for connection with common carrier transmission lines.[45] These developments cast doubt on the propriety of the continued bundling of CPE charges into carrier transmission rates since, as the Commission found, bundling limits the range of CPE available to consumers.[46]

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[42] *Id.*,; *see* United States v. Southwestern Cable Co., 392 U.S. 157, 175-78 (1968).

[43] *See Computer II Final Decision*, 77 F.C.C.2d at 446; *Computer II Reconsidered Decision*, 84 F.C.C.2d at 99.

[44] *See* note 12 *supra*.

[45] *See Computer II Final Decision*, 77 F.C.C.2d at 439-41.

[46] *Id.* at 442.

Thus, the Commission again faced a regulatory crossroads. Because the Commission had decided in *Computer I* not to regulate data processing services,[47] it first considered an approach that would have determined the regulatory status of CPE by classifying it as either communications or data processing.[48] Finding that such a demarcation would inhibit innovation in the production and marketing of CPE by fostering regulatory uncertainty, the Commission discarded the definitional approach, as it had with enhanced services.[49] The Commission was then left with the choice of regulating all CPE under Title II or regulating none. The Commission made the same choice it had made in the case of enhanced services: no CPE would be regulated under Title II.[50] The Commission determined that CPE is not common carrier communications within the scope of Title II [51] and further found that charges for CPE provided by carriers need no longer be regulated via bundling because of the competitive market conditions now prevailing.[52]

Although the Commission discontinued Title II regulation of CPE, it exerted ancillary jurisdiction over carrier-provided CPE. As it had with enhanced services, the Commission found that CPE is within the scope of sections 152 and 153 of the Act, which gives the Commission jurisdiction over "all instrumentalities, facilities, apparatus, and services . . . incidental to" [53] "interstate and foreign communication by wire or radio." [54] The exertion of

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[47] *See* text accompanying notes 2-9 *supra*.

[48] *See Computer II Final Decision*, 77 F.C.C.2d at 436.

[49] *Id.*

[50] *Id.* at 439.

[51] *Computer II Reconsidered Decision*, 84 F.C.C.2d at 61, 65.

[52] *Computer II Final Decision*, 77 F.C.C.2d at 439.

[53] 47 U.S.C. § 153(a) (1976).

[54] *Id.* § 152; *see Computer II Final Decision*, 77 F.C.C.2d at 450-52.

jurisdiction over CPE pursuant to these sections was justified, the Commission found, because including CPE charges in tariffs has a direct effect upon interstate transmission rates.[55] The Commission therefore ordered, first, that all CPE be unbundled from transmission services; that is, no carrier can offer CPE as part of a transmission offering. Second, the Commission ordered that AT&T can offer CPE only through a separate subsidiary. These requirements were designed to ensure fair competition in the CPE market and to prevent AT&T from cross-subsidizing its competitive services through its monopoly services.

Clearly, the Commission's decisions with regard to enhanced services and CPE are complementary. In both cases the Commission confronted rapid technological and market changes and attempted to draw definitional boundaries for the purpose of limiting Title II regulation. In both cases this task proved impossible, and the Commission therefore decided to treat all enhanced services and all CPE alike and remove them from the scope of Title II. The Commission relied in both cases on newly emergent market forces and the exercise of its own ancillary jurisdiction to protect the public interest by assuring availability of enhanced services and CPE at reasonable prices.

The parties' challenges to the Commission's regulatory scheme rest primarily on two bases: first, that the Commission is guilty of impermissible forbearance from Title II regulation in discontinuing rate regulation of all enhanced services and CPE, and second, that the Commission overreached its ancillary jurisdiction in imposing the separation requirement on AT&T and ordering the unbundling of CPE. We view the Commission's decision in *Computer II* as a demarcation of the scope of Title II jurisdiction in a volatile and highly specialized field and a concomitant substitution of alternative regulatory tools for

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[55] *Computer II Final Decision*, 77 F.C.C.2d at 441-46.

traditional Title II regulation in this field. Our analysis proceeds from this foundation.

We first address the Commission's finding that enhanced services and CPE are not common carrier services within the scope of Title II. As we understand it, the Commission's finding in regard to enhanced services has two alternative bases. First, the Commission found that the provision of an enhanced service is not a common carrier activity and, thus, is outside the scope of Title II.[56] Alternatively, the Commission found that even if some enhanced services might be common carrier communications activities within the reach of Title II, it is not required to identify those services and subject them to Title II regulation.[57] A policy of identifying regulable enhanced services would, in the Commission's view, be a reversion to the futile *Computer I* case-by-case approach that inhibited technological innovation and diverted Commission resources from more beneficial activities.[58]

Likewise, the Commission's decision that CPE is not within the scope of Title II rests on two bases. First, the Commission determined that CPE is not itself a common carrier communication service regulable under Title II. In reaching this conclusion, the Commission noted that competition in the CPE market and innovation in the CPE industry occurring apart from the telecommunications network demonstrate that CPE is severable from communications transmission services. Second, the Commission determined that charges for carrier-provided CPE, which traditionally have been regulated in connection with the carrier's provision of transmission services, need no longer be regulated because the new competition in the CPE industry will assure the availability of CPE at reasonable prices.

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[56] *Id.* at 430-32.

[57] *Id.* at 434-35.

[58] *Id.* at 426-27, 434-35.

We believe the Commission's decision not to subject enhanced services or CPE to Title II regulation is sustainable on either of the grounds asserted by the Commission. The Commission's finding that enhanced services and CPE are not common carrier communications activities within Title II is reasonable. Although the Act authorizes regulation of the rates charged for common carrier services, it does not define the term "common carrier." We have noted previously that "the term 'common carrier' has a coherent legal meaning which courts can grasp and apply in reviewing the Commission construction of its own Act." [59] In *National Association of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630 (D.C. Cir.), *cert. denied*, 425 U.S. 992 (1976) (*NARUC I*), we observed that the essential element of common carriage is the carrier's undertaking " 'to carry for all people indifferently.' " [60] In the communications context, this means providing a service whereby customers may " 'transmit intelligence of their own design and choosing.' " [61]

In *Computer II* the Commission found that enhanced services are not the kind of general public offerings this court regarded as common carriage in *NARUC I*. Inherent in enhanced service offerings is the ability of vendors to tailor their services to meet the particularized needs of individual customers.[62] In the Commission's view, this

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[59] National Ass'n of Regulatory Utility Comm'rs v. FCC, 533 F.2d 601, 618 (D.C. Cir. 1976) (*NARUC II*) (opinion of Wilkey, J.) (footnote omitted). It is clear that an entity can be a common carrier with respect to only some of its activities. *Id.* at 608. In this opinion the term "common carrier" will be used to indicate not an entity but rather an activity as to which an entity is a common carrier.

[60] National Ass'n of Regulatory Utility Comm'rs v. FCC, 525 F.2d 630, 640 (D.C. Cir. 1976) (*NARUC I*) (quoting Semon v. Royal Indemnity Co., 279 F.2d 737, 739 (5th Cir. 1960)).

[61] *Id.* at 641 n.58 (quoting Industrial Radiolocation Service, 5 F.C.C.2d 197, 202 (1966)).

[62] *Computer II Final Decision*, 77 F.C.C.2d at 431.

characteristic distinguishes enhanced services from basic services, which are subject to traditional Title II regulation. Further, the Commission found that the severability of CPE from transmission services and the competitive nature of the CPE market demonstrated that CPE is not within the definition of common carriage.

We believe the Commission's judgment that enhanced services do not constitute common carrier communications activities is reasonable and amply supported. The Commission's finding was based upon intensive study of a rapidly changing and highly technical field and was informed by the comments of a large number of participants in the communications and data processing industries. Given the great variety of specialized enhanced services now available to consumers, it is reasonable to find that providers of these services generally are not common carriers because they will "make individualized decisions in particular cases whether and on what terms to serve." [63]

Likewise, the Commission's judgment that CPE is not a common carrier service within Title II is clearly supported. CPE was originally regulated under Title II because regulation was thought necessary for the effective functioning of the interstate communications network, a premise that the Commission has now rejected as fallacious.[64] The severability of CPE from underlying common carrier transmission services, demonstrated by the healthy competition in the CPE market by non-common carriers, supports the Commission's conclusion that CPE is not a common carrier activity within Title II. Moreover, as in any competitive market, provision of CPE is based upon "individualized decisions, in particular cases, whether and on what terms to deal," [65] the hallmark of a non-common carrier service.

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[63] *NARUC II*, 533 F.2d at 609 (footnote omitted).

[64] *Computer II Final Decision*, 77 F.C.C.2d at 446.

[65] *NARUC I*, 525 F.2d at 641 (footnote omitted).

We also find that the Commission's decision is sustainable on the alternative policy ground. We agree with the Commission that even if some enhanced services could be classified as common carrier communications activities, the Commission is not required to subject them to Title II regulation where, as here, it finds that it cannot feasibly separate regulable from nonregulable services. To the extent that certain enhanced services could lawfully be regulated under Title II once they were identified as common carrier services, we sanction the Commission's forbearance from Title II regulation. We emphasize, however, that our sanction is a very narrow one, given in light of the peculiar nature of the communications and data processing industries and the alternative regulatory scheme adopted by the Commission.

The Commission's announced policy is to promote the "efficient utilization and full exploitation of the interstate telecommunications network." [66] This can be best accomplished, in the Commission's view, by regulating the rates of only those activities *clearly* within the scope of Title II.[67] This policy, combined with the Commission's decision in *Computer I* not to regulate data processing services under Title II,[68] compelled the Commission's decision to repudiate an ad hoc approach to determining which enhanced services were regulable as common carrier services. Such case-by-case determinations, the Commission found, would defeat the purpose of the Communications Act, first, by creating regulatory uncertainty that would inhibit market entry and thus limit the range of services available to consumers and, second, by absorbing Commission resources that would be better employed elsewhere.[69]

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[66] *Computer II Final Decision*, 77 F.C.C.2d at 429.

[67] *Id.*

[68] That decision was largely upheld by the Second Circuit in GTE Service Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973). The two rules struck down in *GTE Service Corp.* are not relevant here.

[69] *Computer II Final Decision*, 77 F.C.C.2d at 429-30, 434-35.

Instead of regulating enhanced services under Title II, the Commission used its ancillary jurisdiction to impose upon AT&T a structural regulation scheme that requires AT&T to offer enhanced services only through a separate subsidiary. The Commission found that this separation requirement will effectively protect the public interest by limiting the power of AT&T to gain an unfair advantage in the marketplace by cross-subsidizing its competitive services by its monopoly ones. We believe this to be a sufficient basis to support the Commission's decision not to regulate enhanced services under Title II. Once the difficulty of isolating activities subject to Title II regulation outweighs the benefits to be gained by that regulation, then the Commission is justified in conserving its energies for more efficacious undertakings, at least when it establishes an alternative regulatory scheme under its ancillary jurisdiction.

As it did in the case of enhanced services, the Commission decided on policy grounds not to regulate some CPE—carrier-provided CPE—that it could have permissibly regulated under Title II. This forbearance is lawful. We have already upheld the Commission's finding that provision of CPE is not itself a common carrier activity within Title II. Thus, the Commission could regulate the rates for carrier-provided CPE only if it were necessary to ensure the availability of Title II-regulated communications service at reasonable rates. The Commission found that CPE is now available in an increasingly competitive market, which indicates that CPE will be available at reasonable prices. The Commission further found that discontinuing Title II regulation of all CPE will create economic incentives for carriers to structure services so that customers pay only for what they need.[70] These findings amply support the Commission's conclusion that regulation of charges for carrier-provided CPE is not necessary to protect the public interest.

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[70] *Id.* at 429-30.

Instead of regulating charges for CPE, the Commission has, as in the case of enhanced services, exercised its ancillary jurisdiction to forbid carriers from offering CPE as part of a transmission service and to require AT&T to provide CPE only through a separate subsidiary. The Commission believes that these regulations will ensure healthy competition in the CPE market and will protect the free market forces which will ensure the availability of CPE at reasonable prices by preventing AT&T from cross-subsidizing its competitive services through its monopoly services. We have previously noted our reluctance " to declare that free market forces must be supplanted by rate regulation when neither Congress nor the [agency] has found it essential." [71] We do not believe that Congress required the Commission to regulate carrier-provided CPE under Title II when the agency has determined that an alternative regulatory scheme would more effectively further the goals of the Act. Since the agency's view on this point is reasonable and well supported, we refuse to require the Commission to regulate carrier-provided CPE under Title II.

Our approval of limited forbearance from Title II regulation of common carrier services by the Commission does not give the Commission unfettered discretion to regulate or not regulate common carrier services. This is not a case in which the Commission has attempted to end Title II regulation without substituting other regulatory tools. In *Philadelphia Television Broadcasting Co. v. FCC*, 359 F.2d 282 (D.C. Cir. 1966), we upheld the Commission's decision to regulate CATV systems as "adjuncts of the nation's broadcasting system" [72] rather than as common carriers under Title II, even though we assumed that CATV systems were common carriers. We concluded that

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[71] National Ass'n of Theatre Owners v. FCC, 420 F.2d 194, 204 (D.C. Cir. 1969), *cert. denied*, 397 U.S. 922 (1970).

[72] 359 F.2d at 284.

the latitude accorded the Commission by Congress in dealing with new communications technology includes the discretion to forbear from Title II regulation.[73] Here, as in *Philadelphia Television*, we are faced only with the issue whether the Commission's discretion extends to deciding *what regulatory tools to use in regulating common carrier services:*

> In a statutory scheme in which Congress has given an agency various bases of jurisdiction and various tools with which to protect the public interest, the agency is entitled to some leeway in choosing *which* jurisdictional base and *which* regulatory tools will be most effective in advancing the Congressional objective.[74]

The Second Circuit recently addressed a regulatory scheme similar to that established in *Computer II* and upheld the Commission's action. In *Western Union Telegraph Co. v. FCC*, 674 F.2d 160 (2d Cir. 1982), the court reviewed a Commission order requiring international record carriers to remove their offerings of Telex terminal equipment from tariff. The court upheld the deregulation on alternative grounds. The Commission determined that provision of terminal equipment is not a common carrier communications service in the traditional sense, and the court held this to be reasonable. In the court's view, the petitioners had offered "nothing which casts doubt on the Commission's conclusion that the manufacture and provision of terminal equipment are highly competitive and involve many firms which are not communications carriers. To find in such circumstances that providing terminal equipment is not a communications service is hardly irrational." [75]

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[73] *Id.*

[74] *Id.* at 284 (emphasis added).

[75] 674 F.2d at 166-67.

Moreover, the court rejected petitioners' allegation that continued Title II regulation of terminal equipment was necessary to realize the Commission's statutory goals: "While [petitioners] might believe that IRC transmission rates could be better controlled if equipment remained tariffed, the Commission has broad discretion to choose which regulatory tools to employ . . . and its decision must be upheld unless it is irrational . . . ." [76] The regulatory tools that the court found reasonable were newly unleashed market forces buttressed by the likely future entry of Western Union into the international Telex market.[77] Because the Commission did not attempt to exercise ancillary jurisdiction over the provision of Telex terminal equipment, the regulatory scheme upheld by the Second Circuit was even less stringent than the regulatory scheme established in *Computer II*.

The Commission's exercise of ancillary jurisdiction to impose the separation requirement on AT&T is an integral part of the *Computer II* regulatory scheme. Several parties attack the validity of this assertion of ancillary jurisdiction by the Commission. In *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968), it was settled beyond peradventure that the Commission may assert jurisdiction under section 152(a) of the Act over activities that are not within the reach of Title II.[78] In that case, however, the Supreme Court limited the Commission's jurisdiction to that which is "reasonably ancillary to the effective performance of the Commission's various responsibilities." [79] One of those responsibilities is to assure a nationwide system of wire communications services at reasonable prices.[80]

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[76] *Id.* at 165-66 (citations omitted).

[77] *Id.* at 166.

[78] United States v. Southwestern Cable Co., 392 U.S. at 172-73.

[79] *Id.* at 178.

[80] 47 U.S.C. § 152 (1976).

In *Computer II* the Commission found that the exercise of ancillary jurisdiction over both enhanced services and CPE was necessary to assure wire communications services at reasonable rates. Regulation of enhanced services was deemed necessary to prevent AT&T from burdening its basic transmission service customers with part of the cost of providing competitive enhanced services. This conclusion was based upon detailed findings on AT&T's market power and its ability to underwrite its competitive offerings with profits from its monopoly services.[81] We believe this conclusion is well founded. Because rates for services provided under tariff are based partly upon the costs of providing those services, any misallocation of costs between an entity's competitive and monopoly services would allow the carrier to justify higher rates for its monopoly services. Given this potentially symbiotic relationship between competitive and monopoly services, the agency charged with ensuring that monopoly rates are just and reasonable can legitimately exercise jurisdiction over the provision of competitive services.

Likewise, we believe the Commission acted reasonably in ordering, pursuant to its ancillary jurisdiction, that CPE be removed from tariff. The Commission found that bundling CPE charges into transmission rates has a direct effect upon rates for interstate transmission services.[82] The Commission therefore concluded that exercising jurisdiction over CPE was necessary to carry out its duty to assure the availability of transmission services at reasonable rates. We believe that both the Commission's finding and its conclusion were reasonable. Because CPE charges are not based on usage, including the costs of providing CPE in the calculus for determining the reasonableness of a carrier's rates makes it difficult to identify accurately the costs of providing transmission services, which are

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[81] *See Computer II Final Decision*, 77 F.C.C.2d at 466-70.

[82] *Id.* at 441, 444-46.

priced according to usage. It was therefore reasonable for the Commission to exercise jurisdiction over carrier-provided CPE to ensure that rates for carrier transmission services are not based upon costs associated with the provision of CPE. Thus we conclude that the Commission's exertion of jurisdiction over enhanced services and carrier-provided CPE was "reasonably ancillary" under the *Southwestern Cable* standard.

In designing the Communications Act, Congress sought "to endow the Commission with sufficiently elastic powers such that it could readily accommodate dynamic new developments in the field of communications." [83] Congress thus hoped "to avoid the necessity of repetitive legislation." [84] In *Computer II* the Commission took full advantage of its broad powers to serve the public interest by accommodating a new development in the communications industry, the confluence of communications and data processing. Because the Commission's judgment on "how the public interest is best served is entitled to substantial judicial deference," [85] the Commission's choice of regulatory tools in *Computer II* must be upheld unless arbitrary or capricious.[86] Our review of the Commission's decision convinces us that the Commission acted reasonably in defining its jurisdiction over enhanced services and CPE. We therefore uphold the *Computer II* scheme.

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[83] General Telephone Co. of the Southwest v. United States, 449 F.2d 846, 853 (5th Cir. 1971).

[84] National Ass'n of Theatre Owners v. FCC, 420 F.2d 194, 199 (D.C. Cir. 1969) (footnote omitted), *cert. denied*, 397 U.S. 922 (1970); *see* General Telephone Co. of California v. FCC, 413 F.2d 390, 398 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969).

[85] FCC v. WNCN Listeners Guild, 450 U.S. 582, 596 (1981).

[86] 5 U.S.C. § 706(2)(a) (1976); *see, e.g.*, Malrite Television v. FCC, 652 F.2d 1140, 1149 (2d Cir. 1981), *cert. denied*, 102 S. Ct. 1002 (1982).

B. *Preemption of State Regulation of CPE*

Some parties argue that the Commission's decision to order the states to remove CPE charges from their tariffs is an unjustifiable invasion of the authority to regulate intrastate communications services reserved to the states by the Act. To determine whether the Commission acted properly in preempting state tariffing of CPE, we must examine the Commission's powers under the Act and the asserted justification for preempting state regulation.

We have already held that the exertion of ancillary jurisdiction over carrier-provided CPE was proper under section 2(a) of the Act, which gives the Commission broad authority over "all interstate and foreign communication by wire or radio," [87] and section 3(a) of the Act, which defines "communication by wire" to include not only transmission but also "all instrumentalities, facilities, [and] apparatus . . . incidental to such transmission." [88] Many parties argue, however, that the Commission cannot exercise its ancillary jurisdiction so as to preempt state regulation of CPE. The conflict between federal and state power over CPE arises because most CPE in this country is used interchangeably for both interstate and intrastate communication and has traditionally been subject to both state and federal regulation. The cost of providing CPE has been apportioned between interstate and intrastate use and then bundled into the appropriate transmission rates.[89] Thus, it is argued, the Commission's assertion of its ancillary jurisdiction to require removal of CPE charges from state tariffs conflicts with section 2(b) of the Act, which confers on the states jurisdiction over instrumentalities of intrastate communication.[90]

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[87] 47 U.S.C. § 152(a) (1976).

[88] *Id.* § 153(a).

[89] *See Computer II Final Decision*, 77 F.C.C.2d at 441-42.

[90] 47 U.S.C. § 152(b) (1976).

The Commission asserts that preemption of state regulation is justified in this case because the objectives of the *Computer II* scheme would be frustrated by state tariffing of CPE. We agree. Courts have consistently held that when state regulation of intrastate equipment or facilities would interfere with achievement of a federal regulatory goal, the Commission's jurisdiction is paramount [91] and conflicting state regulations must necessarily yield to the federal regulatory scheme.[92] In *Computer II* the Commission found that its policy of promoting the "efficient utilization and full exploitation of the interstate telecommunications network" [93] is furthered by fostering competition in the CPE market and giving consumers an unfettered selection of CPE. According to the Commission, competition in the equipment market has had the beneficial effects of stimulating innovation, making available a wider range of equipment, improving maintenance and reliability, and increasing purchase, payment, and installation options.[94] When charges for CPE are bundled into transmission charges, the Commission found, the benefits of a competitive market are partially lost because consumers' freedom of choice is limited. Only if charges for CPE are entirely separate from charges for transmission service will consumers be free to select the CPE that best suits their individual needs and preferences.[95]

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[91] *See, e.g.*, New York Telephone Co. v. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980); California v. FCC, 567 F.2d 84, 86-87 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978); Puerto Rico Telephone Co. v. FCC, 553 F.2d 694, 698-700 (1st Cir. 1977).

[92] Brookhaven Cable TV, Inc. v. Kelly, 573 F.2d 765, 767 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1979); *NARUC I*, 525 F.2d at 646-47.

[93] *Computer II Final Decision*, 77 F.C.C.2d at 429.

[94] *Id.* at 439.

[95] *See id.* at 442-43.

The Commission therefore concluded that the only way to give consumers an unfettered choice of CPE was to require that charges for CPE be completely severed from transmission rates on both the federal and state levels. Since consumers use the same CPE in both interstate and intrastate communications and generally wish to purchase both interstate and intrastate transmission services, the inclusion of CPE in charges for intrastate transmission service will certainly influence the consumer's choice of CPE. The Commission believes this restriction will be detrimental to both the consumer and the interstate communication system. Given the Commission's detailed and logical findings on this point, we cannot say the Commission's conclusion is irrational.

Our decision today is in accord with two leading cases in which the Fourth Circuit recognized that state regulation which impedes a federal regulatory goal must yield to the federal scheme. The Fourth Circuit also confirmed the Commission's jurisdiction over CPE used jointly in interstate and intrastate communications and rejected the argument that section 2(b) of the Act absolutely prohibits federal jurisdiction over jointly used CPE. In *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*NCUC I*), the court upheld the Commission's authority to determine the terms on which consumers may attach non-carrier-provided CPE to transmission facilities used for both interstate and intrastate communications.[96] The court also held that section 2(b) deprives the Commission of power over local services or facilities only where

> their nature and effect are separable from and do not substantially affect the conduct or development

[96] North Carolina Utilities Comm'n v. FCC, 537 F.2d 787, 793-95 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*NCUC I*); North Carolina Utilities Comm'n v. FCC, 552 F.2d 1036, 1044-52 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (*NCUC II*).

> of interstate communications. But beyond that, we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under sections 201 through 205.[97]

In the second leading case the Fourth Circuit reaffirmed its ruling in *NCUC I*:

> [We] correctly reasoned that if section 2(b)(1) were construed to give the states primary authority over joint terminal equipment, *i.e.*, equipment used interchangeably for interstate and intrastate service, then—whenever state regulations conflicted with federal rules applicable to interstate calls—the FCC would necessarily be prevented from discharging its statutory duty under sections 1 and 2(a) to regulate interstate communication.[98]

Computer II is, we believe, just such a case in which conflicting state regulations would impede the Commission in its effort to fulfill its statutory duty.

Several parties attempt to distinguish the *NCUC* cases on the ground that they did not involve Commission attempts to preempt state *ratemaking* authority. They argue that section 2(b) prohibits preemption of state tariffing of CPE. They point out that section 2(b) was designed to protect state authority over intrastate rates, enacted as it was in response to a Supreme Court decision that Congress feared would be read to permit federal agencies to set local rates based on the indirect effects such rates might have on interstate service.[99] We do not

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[97] *NCUC I*, 537 F.2d at 793.

[98] *NCUC II*, 552 F.2d at 1045.

[99] Houston, E. & W. Texas Ry. Co. v. United States, 234 U.S. 342 (1914) (*Shreveport*). In *Shreveport* the Supreme Court upheld an ICC order that, in effect, required the revision of intrastate railroad rates that were lower than rates for comparable interstate rail services so as to remove the

believe that section 2(b) prohibits preemption in this case. In *Computer II* the Commission has neither attempted to set rates for intrastate communications services or facilities nor asserted jurisdiction over matters of state concern because of intrastate discrimination against interstate business. Rather, the Commission here exercised its direct authority to determine the regulatory treatment of CPE used for interstate communications.

We fail to see any distinction in this case between preemption principles applicable to state ratemaking authority and those applicable to other state powers. The operative principle in this case is precisely the principle that demanded state preemption in the *NCUC* cases. There, the preemption of state regulations that restricted interconnection was justified because those regulations impeded the validly adopted federal policy of unrestricted interconnection. Similarly, in *Computer II* preemption of state tariffs on CPE is justified because state tariffs would interfere with the consumer's right to purchase CPE separately from transmission service and would thus frustrate the validly adopted federal policy. In *Computer II* the federal-state conflict would stem, as it did in the *NCUC* cases, from the practice of using CPE jointly for interstate and intrastate communication. The conflicting state policy, meant to affect only intrastate use, would unavoidably affect the federal policy adversely. Therefore, here, as in *NCUC I* and *II*, the state regulatory power must yield to the federal.

In addition, the Act itself does not distinguish between authority over rates and authority over other aspects of

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resulting discrimination against interstate commerce. Congress may well have intended § 2(b) of the Communications Act to prevent such a result in the communications area. *See Federal Communications Commission: Hearings on S. 2910 Before the Senate Comm. on Interstate Commerce*, 73d Cong., 2d Sess. 153, 155 (1934) (statement of K.F. Clardy); *id.* at 155-56 (statement of Andrew R. McDonald); *NCUC II*, 552 F.2d at 1047.

communications. Sections 2(a) and (b) of the Act allocate federal and state authority with regard to both "*charges* [and] . . . facilities." [100] Therefore, conflicting federal and state regulations regarding dual use CPE are no more acceptable under the Act when equipment rates are involved, as here, than when interconnection policies are involved, as in the *NCUC* cases.

In the *NCUC* cases, the Fourth Circuit also found that section 221(b) of the Act [101] did not constitute a bar to federal control of dual use CPE. That section provides that the Commission has no jurisdiction over state-regulated charges, facilities, or other matters "for or in connection with . . . telephone exchange service . . . even though a portion of such exchange service constitutes interstate or foreign communication." [102] The Fourth Circuit found on the basis of the legislative history that this provision was merely intended to preserve state regulation of local exchanges that happened to overlap state lines.[103] We have reviewed the legislative history and also conclude that section 221(b) is inapplicable in the circumstances of this case. Both the Senate and House committee reports specifically note that section 221(b) is intended to enable states "to regulate exchange services in metropolitan areas overlapping State lines." [104] To the extent we appeared in *Kitchen v. FCC*, 464 F.2d 801 (D.C. Cir. 1972), to take

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[100] 47 U.S.C. § 152(b)(1) (1976).

[101] *Id.* § 221(b).

[102] *Id.*

[103] *See NCUC II*, 552 F.2d at 1045; *NCUC I*, 537 F.2d at 795. The Fourth Circuit's interpretation of § 221(b) has been followed by the First Circuit, Puerto Rico Telephone Co. v. FCC, 553 F.2d 694, 698-99 (1st Cir. 1977), and by the Second Circuit, New York Telephone Co. v. FCC, 631 F.2d 1059, 1064-65 (2d Cir. 1980).

[104] S. REP. No. 781, 73d Cong., 2d Sess. 5 (1934); H.R. REP. No. 1850, 73d Cong., 2d Sess. 7 (1934).

a different view of the meaning of section 221(b), we now reject the *Kitchen* analysis and adopt what we believe to be the more sound interpretation of that section expounded by the Fourth Circuit in the *NCUC* cases.

Some parties also argue that the Commission has unlawfully attempted to preempt state regulation of dual use CPE by creating a vacuum of deregulation. They contend that preemption can be accomplished only by affirmative regulation that occupies the field. These parties misapprehend the Commission's actions. Although the Commission has discontinued Title II regulation of CPE, it has substituted a different, *affirmative* regulatory scheme through its ancillary jurisdiction.[105] Furthermore, we perceive no critical distinction between preemption by Title II regulation and preemption by the exercise of ancillary jurisdiction.[106] It is clear to us that the *Computer II* regulations embody a comprehensive federal regulatory scheme, including rules governing the marketing of CPE by common carriers. We agree with the Second Circuit: "Federal regulation need not be heavy-handed in order to preempt state regulation." [107]

Some parties argue forcefully that the states, like the Commission, have a responsibility to protect the interests of consumers and that the best way to do this is to continue to tariff CPE. We cannot engage in debate about whether a policy of price control through tariffing or a policy of free competition best serves the public interest

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[105] This scheme includes continued regulation of interconnection for all CPE and strengthening of all interconnection opportunities, establishment of unbundled charges, and structural separation to guard against cross-subsidization where necessary.

[106] *Accord* Brookhaven Cable TV, Inc. v. Kelly, 573 F.2d 765 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1979).

[107] New York State Comm'n on Cable Television v. FCC, 669 F.2d 58 (2d Cir. 1982).

in this area. All we are empowered to do is to determine whether the Commission had the statutory authority to adopt the policy it did and whether that policy is arbitrary or capricious or an abuse of discretion. We believe that Congress has empowered the Commission to adopt policies to deal with new developments in the communications industry and that the policy favoring regulation by marketplace forces embodied in *Computer II* is neither arbitrary, capricious, nor an abuse of discretion. With this holding our review of the wisdom of state preemption is at an end.

It is also contended that the Commission failed to give adequate notice of its intention to detariff CPE and to preempt state tariffing. We reject this argument. In the *Tentative Decision* issued almost a year prior to the *Final Decision*, the Commission retained tariff regulation of "basic" CPE, but queried "whether it would be more advantageous to the consumer for all customer-premises equipment to be provided solely on a non-tariffed basis." [108] The Commission solicited comments on six options, including "deregulation of . . . all customer-premises equipment." [109] The Commission did not, in the *Tentative Decision*, explicitly state that preemption of state regulations was under consideration. Such a statement was not necessary, for preemption of any inconsistent state regulatory scheme would follow automatically under the Supremacy Clause and other principles discussed above. In any event, preemption was explicit in the *Final Decision*. The state parties had—and took full advantage of—opportunities to voice their objections to the Commission's decision. The Commission entertained petitions for reconsideration of the *Final Decision* and in fact made changes to accommodate concerns expressed by the states.[110]

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[108] *Computer II Tentative Decision*, 72 F.C.C.2d at 438.

[109] *Id.* at 441.

[110] For example, in its *Reconsidered Decision* the Commission adopted a bifurcation plan that should ameliorate state

We thus reject the parties' challenges to the Commission's power to preempt state regulation of CPE that is inconsistent with the *Computer II* rules.

C. *Separation*

A number of parties attack the Commission's decision by contending that the separate subsidiary requirement should have been imposed on at least some common carriers in addition to AT&T. Others challenge the separation aspect of the *Computer II* rules on the basis that the separate subsidiary requirement imposed on AT&T is not sufficiently rigorous. In our view both of these arguments represent, in essence, disagreement with a choice made by the Commission among several reasonable policy options. Those who disagree with the Commission's decision on how and where to draw the line regarding the separation question would have this court substitute its judgment for that of the Commission. This we are neither authorized nor inclined to do.

In *Computer II* the Commission sought to strike a reasonable balance between competing concerns; this task was specifically delegated to the agency by Congress and should be accorded special deference by the judiciary. Our function here is only to ensure that the Commission's action in adopting the separation scheme did not constitute an abuse of discretion. We are convinced that the Commission engaged in reasoned decisionmaking well within the scope of its discretion, and we therefore uphold the separation portion of the *Computer II* rules.

In its decision the Commission explained that the maximum separation requirement would apply only to AT&T since, in the Commission's judgment, AT&T is the only

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concerns regarding immediate impact on state regulation of existing CPE. In its *Further Reconsidered Decision* the Commission stated that it would allow the states to establish additional accounting requirements and structural separation for carriers other than AT&T.

common carrier having "sufficient market power to engage in effective anti-competitive activity on a national scale and . . . sufficient resources to enter the competitive market through a separate subsidiary." [111] Originally, the Commission decided to subject GTE to the separation requirement also,[112] but after receiving additional comments from the industry, decided to exempt GTE.[113]

We believe this to be a reasonable judgment on the Commission's part. The Commission's task of developing a policy to carry out its goal of encouraging competition was a difficult one. Through the separation requirement the Commission sought to protect the public from unfair competition by powerful carriers. At the same time the Commission tried to ensure that competition would be strengthened by the entry of less powerful carriers into the market by exempting from the separation requirement those carriers that cannot engage in significant anti-competitive conduct.

In reaching its decision to impose separation only on AT&T, the Commission considered four factors: (1) the carrier's ability to engage in anti-competitive activity through its control of local exchange facilities, (2) the carrier's ability to cross-subsidize its competitive activities through its monopoly services, (3) the degree to which the carrier possesses integrated research and manufacturing capabilities, and (4) the carrier's economic ability to enter the market through a separate subsidiary.[114] The Commission also noted statistics regarding each carrier's revenues, market share, and market size.[115] It seems to us that the basis for the Commission's decision

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[111] *Computer II Final Decision*, 77 F.C.C.2d at 469.

[112] *Id.* at 389.

[113] *Computer II Reconsidered Decision*, 84 F.C.C.2d at 72.

[114] *Id.*

[115] *Computer II Final Decision*, 77 F.C.C.2d at 469-71.

is rational and adequately explained. We are not inclined to quarrel with the expert agency's judgment, especially when, as here, the Commission exhibited thoughtful deliberation by exempting GTE from the separation requirement after receiving more information about the nature and extent of GTE's resources.[116]

Moreover, certain safeguards were adopted with regard to the exempt carriers. For example, if such carriers wish to offer enhanced services, they must sell themselves the basic transmission service "pursuant to the terms and conditions embodied in their tariff." [117] Exempt carriers are also required to adopt adequate accounting measures to ensure that costs and revenues from their regulated and unregulated activities are not improperly commingled.[118] The Commission noted its readiness to impose the separation requirement more broadly in the future if circumstances warrant.[119] We therefore hold that limiting the separation requirement to AT&T was not arbitrary, capricious, or an abuse of discretion.

Likewise, we reject the argument that the structural separation requirement imposed on AT&T is impermissibly lenient. We need not discuss the mechanical details of the separation scheme. It is sufficient to note that the scheme relies upon corporate separateness, accounting procedures, and resale requirements to ensure that no cross-subsidization or unfair competitive practices occur. No aspect of the *Computer II* rules more warrants our deference than these requirements. The Commission, having chosen a permissible regulatory tool—structural separation—set out detailed plans for implementing it.

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[116] *Computer II Reconsidered Decision*, 84 F.C.C.2d at 72-73.

[117] *Id.* at 75 n.19.

[118] *Computer II Final Decision*, 77 F.C.C.2d at 476.

[119] *Computer II Further Reconsidered Decision*, 88 F.C.C.2d at 541.

These plans were based upon the Commission's own expertise and experience in regulating the communications industry and upon the comments of the members of that industry. This court is ill-prepared to decide which mechanical requirements would best implement the structural separation scheme. Our only province is to determine whether the separation requirements were "based on a consideration of the relevant factors and whether there has been a clear error of judgment." [120]

Among the factors considered by the Commission in formulating the details of the separation scheme were the comments of various parties, business practices in the communications industry, the costs and benefits of various degrees of separation, and the efficacy of various separation tools. We have perused the Commission's decision carefully, and we find that these requirements were based upon consideration of the relevant factors. In addition, we find no clear error of judgment in the Commission's choice of the degree of separation necessary and its reliance upon certain separation tools in preference to others. Therefore, we uphold the *Computer II* separation regulations in their entirety.

D. *Consent Decree Issues*

In 1949 the Justice Department sued AT&T and its manufacturing subsidiary, Western Electric, alleging various antitrust violations. The litigation ended in 1956 when a consent decree was approved by the United States District Court for the District of New Jersey.[121] The consent decree placed severe restrictions on AT&T's entry into unregulated non-communications markets.[122] In de-

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[120] Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

[121] United States v. Western Electric Co., 1956 Trade Cas. (CCH) ¶ 68,246 (D.N.J. 1956).

[122] Section V of the consent decree prohibits AT&T and all of its subsidiaries, except Western Electric and Western

signing the *Computer II* regulatory scheme, the Commission concluded that AT&T's participation in the new regime would be compatible with the consent decree. Although the Commission recognized that it could not definitively construe the decree,[123] it expressed its belief that the separate subsidiary requirement set forth in the *Computer II* decision constituted sufficient "public regulation" of AT&T's offerings of CPE and enhanced services to satisfy the demands of the consent decree.[124]

Several parties urge this court to reverse the Commission's decision in *Computer II* on the theory that it rests upon an *ultra vires* and incorrect interpretation of the 1956 consent decree. They suggest that this court should review and reject the Commission's reading of the decree. This issue has been largely mooted by vacation of the consent decree as part of the settlement of the Justice Department's 1974 antitrust suit against AT&T.[125]

However, we do note that the Commission's consideration of the effect of the consent decree upon the *Computer II* rules was not improper and did not taint the regulations. The Commission did not purport to construe the decree; rather, the existence of the decree and its meaning in the Commission's view were simply circumstances affecting the communications industry. It was entirely

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Electric subsidiaries, from engaging in any business activities aside from "the furnishing of common carrier communications services," *id.* at 71,138, defined by Section II(i) as "communications services and facilities . . . the charges for which are subject to public regulation under the Communications Act of 1934," *id.* at 71,137.

[123] *Computer II Final Decision*, 77 F.C.C.2d at 492.

[124] *Id.* at 492-93.

[125] Opinion, United States v. American Telephone & Telegraph Co., Civ. Action No. 74-1698, at 83-100 (D.D.C. Aug. 11, 1982), *as modified*, Civ. Action No. 82-0192 (D.D.C. Aug. 24, 1982).

proper for the Commission to take these circumstances into account in formulating the *Computer II* rules. Even though vacation of the decree has now changed these circumstances, it is clear to us that considerations prompted by the decree are not so fundamental to the *Computer II* scheme that the decree's vacation vitiates the basis for the regulations. Thus, we reject the challenges based on the consent decree issue.

III. Conclusion

For the foregoing reasons, the decision of the Commission is

Affirmed.

47 U.S.C. §152. Application of chapter

(a) The provisions of this chapter shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio communication or transmission wholly within the Canal Zone.

(b) Except as provided in section 224 of this title and subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carrier to

which clause (2) or clause (3) of this subsection would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201-205 of this title shall, except as otherwise provided therein, apply to carriers described in clauses (2)–(4) of this subsection.

47 U.S.C. §203. Schedules of charges; filing with Commission; changes in schedules; overcharges and rebates; penalty for violations

(a) Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall designate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and points on the system of its connecting carriers or points on the system of any other carrier subject to this chapter when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. Such schedules shall contain such other information, and be printed in such form, and be posted and kept open for public inspection in such places, as the Commission may by regulation require, and each such schedule shall give notice of its effective date; and such common carrier shall furnish such schedules to each of its connecting carriers, and such connecting carriers shall keep such schedules open for inspection in such public places as the Commission may require.

(b)(1) No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published except after ninety days notice to the Commission and to the public, which shall be published in such form and contain such information as the Commission may by regulations prescribe.

(2) The Commission may, in its discretion and for good cause shown, modify any requirement made by or under the authority of this section either in particular instances or by general order applicable to special circumstances or conditions except that the Commission may not require the notice period specified in paragraph (1) to be more than ninety days.

(c) No carrier, unless otherwise provided by or under authority of this chapter, shall engage or participate in such communication unless schedules have been filed and published in accordance with the provisions of this chapter and with the regulations made thereunder; and no carrier shall (1) charge, demand, collect, or receive a greater or less or different compensation for such communication, or for any service in connection therewith, between the points named in any such schedule than the charges specified in the schedule then in effect, or (2) refund or remit by any means or device any portion of the charges so specified, or (3) extend to any person any privileges or facilities in such communication, or employ or enforce any classifications, regulations, or practices affecting such charges, except as specified in such schedule.

(d) The Commission may reject and refuse to file any schedule entered for filing which does not provide and give lawful notice of its effective date. Any schedule so rejected

by the Commission shall be void and its use shall be unlawful.

(e) In case of failure or refusal on the part of any carrier to comply with the provisions of this section or of any regulation or order made by the Commission thereunder, such carrier shall forfeit to the United States the sum of $500 for each such offense, and $25 for each and every day of the continuance of such offense.

47 U.S.C. §221. Telephone companies; consolidation; state jurisdiction over services, charges, etc., unaffected; determination of property used in interstate toll service; valuation

(a) Upon application of one or more telephone companies for authority to consolidate their properties or a part thereof into a single company, or for authority for one or more such companies to acquire the whole or any part of the property of another telephone company or other telephone companies or the control thereof by the purchase of securities or by lease or in any other like manner, when such consolidated company would be subject to this chapter, the Commission shall give reasonable notice in writing to the governor of each of the States in which the physical property affected, or any part thereof, is situated, and to the State commission having jurisdiction over telephone companies, and to such other persons as it may deem advisable, and shall afford such parties a reasonable opportunity to submit comments on the proposal. A public hearing shall be held in all cases where a request therefor is made by a telephone company, an association of telephone companies, a State commission, or local governmental authority. If the Commission finds that the proposed consolidation, acquisition, or control will be of advantage to the persons to whom

service is to be rendered and in the public interest it shall certify to that effect; and thereupon any Act or Acts of Congress making the proposed transaction unlawful shall not apply. Nothing in this subsection shall be construed as in anywise limiting or restricting the powers of the several States to control and regulate telephone companies.

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local govemmental authority.

(c) For the purpose of administering this chapter as to carriers engaged in wire telephone communication, the Commission may classify the property of any such carrier used for wire telephone communication, and determine what property of said carrier shall be considered as used in interstate or foreign telephone toll service.Such classification shall be made after hearing, upon notice to the carrier, the State commission (or the Governor, if the State has no State commission) of any State in which the property of said carrier is located, and such other persons as the Commission may prescribe.

(d) In making a valuation of the property of any wire telephone carrier the Commission, after making the classification authorized in this section, may in its discretion value only that part of the property of such carrier determined to be used in interstate or foreign telephone toll service.